CASE NO. _______ **EXEMPT UNDER GOV'T CODE § 6103**

IN THE CALIFORNIA COURT OF APPEAL FOR THE FOURTH APPELLATE DISTRICT DIVISION ONE

THE CITY OF SAN DIEGO,

Petitioner,

v.

SUPERIOR COURT OF THE STATE OF CALIFORNIA, COUNTY OF SAN DIEGO,

Respondent.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM, by and through its Board of Administration; LOCAL 127, AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES; SAN DIEGO MUNICIPAL EMPLOYEES' ASSOCIATION; SAN DIEGO CITY FIREFIGHTERS, LOCAL 145; and the *ABDELNOUR* Plaintiffs,

Real Parties In Interest.

PETITION FROM THE SUPERIOR COURT OF THE STATE OF CALIFORNIA FOR THE COUNTY OF SAN DIEGO, THE HONORABLE JEFFREY B. BARTON, CASE NO. GIC841845 [CONSOLIDATED WITH GIC851286 and GIC852100]

PETITION FOR WRIT OF MANDATE OR OTHER APPROPRIATE RELIEF

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PETITION FOR WRIT OF MANDATE OR OTHER APPROPRIATE RELIEF

TO THE HONORABLE PRESIDING JUSTICE AND THE HONORABLE ASSOCIATE JUSTICES OF THE CALIFORNIA COURT OF APPEAL, FOURTH APPELLATE DISTRICT:

I.

INTRODUCTION

In the most significant civil litigation in San Diego's history—involving hundreds of millions of dollars of illegal public employee pension benefits—the trial court issued a Statement of Decision which guts the City's case challenging those benefits and pushes the City to the brink of bankruptcy. Blurring *res judicata* and other concepts, the court held that the bulk of the case fails because subsequent events purportedly ratified—*sub silentio*—the unquestionable violations of state and local conflict of interest and debt liability limit laws which occurred. This was gross legal error: Governmental actions violating conflict of interest laws are ***void*** (not merely voidable), and ***they cannot be cured by ratification, estoppel or waiver.*** The trial court's decision, permitting tainted official conduct to bind the City and its taxpayers to the results of wrongdoing into perpetuity, is without precedent in the annals of state conflict of interest law.

As the Court of Appeal recently wrote regarding the central conflict of interest statute at issue:

> To construe the statute narrowly would permit certain categories of schemes and improprieties to go unchecked, a result which would undermine the public's confidence not only in the government, but in the court system ruling on such cases. An important, prophylactic statute such as section

> 1090 should be construed broadly to close loopholes; it should not be constricted and enfeebled.

Carson Redevelopment Agency v. Padilla, 140 Cal. App. 4th 1323, 1335 (2006). Casting *Carson* aside, the trial court's ruling permits *quid pro quo* schemes not only to go unchecked, but to go unexamined.

Petitioner the City of San Diego (the "City") respectfully requests that this Court issue a writ of mandate or other appropriate writ relief to compel Respondent Superior Court to set aside the court's January 18, 2007 Statement of Decision on Phase I of the trial. Immediate appellate review is essential to the City's ability to attain financial health and stability, and to provide legal certainty as this monumental case proceeds through the remaining phases of the trial.

II.

PETITION

By this Petition, Petitioner alleges and shows as follows:

A. BENEFICIAL INTEREST OF PETITIONER, CAPACITY OF RESPONDENT AND REAL PARTIES IN INTEREST

1. Petitioner City is a Defendant and the Cross-Complainant in a pending Superior Court action, *San Diego City Employees' Retirement System v. San Diego City Attorney Michael J. Aguirre; The City of San Diego*, San Diego County Superior Court Case No. GIC841845 (this "Case"). Petitioner is and, at all times mentioned herein, was a charter city duly organized and existing under the laws of the State of California and situated in the County of San Diego.

2. Respondent Superior Court of the State of California, County of San Diego, is now, and at all times mentioned in this Petition, has been a court exercising judicial functions in connection with this Case.

3. The Real Parties in Interest are the San Diego City Employees' Retirement System (by and through its Board of Administration), which is the Plaintiff in this Case, and multiple parties that intervened or are parties in this or other of the consolidated cases: Local 127, American Federation of State, County and Municipal Employees, AFL-CIO ("Local 127"); San Diego Municipal Employees' Association ("MEA"); San Diego City Firefighters, Local 145, IAFF, AFL-CIO ("Local 145"); and the *Abdelnour* Plaintiffs (collectively, "Intervenors").

B. STATEMENT OF THE CASE

4. A detailed recitation of the procedural and factual history of the Case is set forth in the Memorandum of Points and Authorities and incorporated herein by this reference.

C. WHY EXTRAORDINARY RELIEF IS WARRANTED

5. This Petition seeks a writ of mandate or other appropriate writ relief under California Code of Civil Procedure Section 1085 and common law. Absent relief by this Court, the City faces irreparable injury in numerous respects:

a. The City is in a state of financial crisis. This is due to a confluence of events, but the underpinning and largest components of the financial emergency are the employee pension benefits that were awarded under two schemes, commonly known as Manager's Proposal I ("MP I") and Manager's Proposal II ("MP II"). The legality of those schemes is at the heart of this case. The MP I and MP II benefit increases were granted through illegal *quid pro quo* arrangements, in which members of the San Diego City Employees' Retirement System ("SDCERS") Board of Administration abdicated their fiduciary duty to protect the funding of the employee benefits, and instead allowed underfunding of the retirement system to occur in exchange for benefit increases that individually (and specially) benefited them.

b. Largely due to those illegal activities, the City now faces seemingly insurmountable liabilities. The City has a deficit of between $1 billion and $1.4 billion for employee retirement benefits funding, and another approximately $1.4 billion for retiree healthcare costs. Thus, the City's total employee benefit deficit is nearly $3 billion, as compared with a total General Fund of only $1 billion. That debt alone amounts to about $12,000 for every San Diego household. The City simultaneously is facing multi-million dollar requirements for infrastructure improvements—including water, wastewater and storm water facilities and sewage treatment—which are in many instances mandatory under federal and state law. The City's streets and roads have deteriorated to the point where they are among the worst in the nation, with about 60% of the City's roadways needing work. The City already has engaged in drastic and painful program reductions, reducing services to essential minimums, and there is now little or no excess to cut.

c. The net effect of the City's dire financial condition is that the City's highest officials are being forced to consider municipal bankruptcy proceedings, other debt restructuring and trusteeship options, severe cuts in City services (including parks and libraries), and other emergency measures. Even under the Mayor's Five Year Outlook, which is based on highly optimistic assumptions, the City faces a budget deficit of nearly $800 million over the next 5 years—even after these drastic cuts and without accounting for contemplated police or other employee pay raises.

6. The City hoped that this Case would provide judicial relief as to employee benefit funding obligations that unquestionably are predicated upon illegal acts, bringing a substantial measure of salvation for the City. At a minimum, a judicial declaration that a civil violation of Government Code Section 1090 (which prohibits public officials from taking action in matters in which they have a financial interest) has occurred, and a remand to the City Council for new action free from the taint of conflict of interest, would allow the City officials to cure the prior conflict of interest violations and to recalibrate past benefit awards with actual funding resources. Such relief would also provide leverage to negotiate with the unions to set total compensation and benefits at realistic amounts, thereby preserving the City's ability to provide services and to continue to employ the public employees to do so.

7. Rather than providing a panacea to these difficulties, however, the trial court's Phase I decision largely destroys the City's case and worsens its already tenuous position. Even if the City prevails on the remaining phases, the amount of illegal pension benefits that will be set aside is a mere fraction of the $900 million previously at issue. The court's Phase I decision essentially eliminated the City's last, best hope for meaningful relief from the illegal pension benefits that were placed on the public books—and loaded on the taxpayers' backs—through backroom deals that directly violated state and local conflict of interest laws.

8. Not only does the Phase I decision essentially extinguish the financial relief that the City stands to gain by this case, but it delays legal certainty and finality. The decision removed MP I and the debt liability limit laws from consideration

entirely, and it excluded most of the MP II benefits from the case. If the Phase I decision is not immediately reviewed, the entire case will have to be retried if the Phase I determinations are reversed on appeal from final judgment. In addition, the trial record will be incomplete because the Phase II and III issues of statutes of limitation and liability will not be litigated as to MP I or the debt limit laws. Immediate appellate review before the trial of the remaining phases therefore furthers the public interest in having a prompt resolution of the pivotal questions at issue (and the fiscal certainty that such legal finality can provide), and furthers the judicial interest in avoiding the need for two lengthy, complex trials in the same case.

9. As matters now stand under the court's decision, there is also inequity among the City's pension beneficiaries. Under the court's rulings that MP I benefits may not be considered, and the legality of MP II benefit increases can be challenged only as to those City employees fortuitously excluded from the settlement of an earlier class action, a few employees are left to bear the consequences of the entire illegal course of conduct. Moreover, all beneficiaries suffer because the court's ruling leaves the pension system at risk: the benefits technically exist, but lack the foundation of real funding. Hence, the beneficiaries, too, face irreparable harm from the trial court's erroneous ruling.

10. Immediate relief is warranted because the trial court's Statement of Decision is both clearly erroneous and substantially prejudicial to the City and others. *See, e.g.*, *Roden v. AmerisourceBergen Corp.*, 130 Cal. App. 4th 211, 218 (2005); *Babb v. Super. Ct.*, 3 Cal. 3d 841, 851 (1971). Writ review will lie to resolve issues of first

impression that are of widespread interest. *California Highway Patrol v. Super. Ct.*, 135 Cal. App. 4th 488, 496 (2006); *Omaha Indemnity Co. v. Super. Ct.*, 209 Cal. App. 3d 1266, 1273 (1989); *Whitney's at the Beach v. Super. Ct.*, 3 Cal. App. 3d 258, 264 (1970).

11. Moreover, when the issues presented are questions of law, their immediate resolution on a petition for writ of mandate is appropriate. *Fisherman's Wharf Bay Cruise Corp. v. Super. Ct.*, 114 Cal. App. 4th 309, 319 (2003).

12. Writ review also is appropriate because the trial court's order deprives the City of the opportunity to present a significant portion of its case. *Roden*, 130 Cal. App. 4th at 218; *Fatica v. Super. Ct.*, 99 Cal. App. 4th 350, 351 (2002).

13. The Superior Court's ruling is erroneous as a matter of law because:

a. The 2000 settlement in the *Corbett* case could not bar the City from litigating the violation of conflict of interest laws that occurred with the adoption of MP I because (1) *Corbett* did not involve any right or issue relating to MP I or conflict of interest laws, and hence neither claim preclusion nor issue preclusion (nor "estoppel," the trial court's term) applies; and (2) a governmental action in violation of Section 1090 is void and cannot (as the trial court found) be cured by ratification or estoppel. The *Corbett* settlement and intervening Memoranda of Understanding also did not supersede MP I because those events occurred when the original wrongdoers remained in control, and did not examine or cure the original wrongdoing.

b. The 2004 settlement in the *Gleason* case could not bar the City from litigating the violation of conflict of interest laws that occurred with the adoption of MP I and MP II because (1) *Gleason I* (the only prior case involving the City) did not involve the issue of conflicts of interest under Section 1090; (2) the City was not required to assert a compulsory cross-complaint against its codefendant, SDCERS, which is the defendant here; (3) the *Gleason* settlement itself precludes such an interpretation; and (4) *res judicata* will not apply when it is against the public interest.

c. The City can state a valid declaratory relief claim against SDCERS for violation of the state and local debt limit laws, which preclude the City from incurring debt without corresponding revenue. There is an actual controversy between SDCERS and the City—whether the creation of benefits pursuant to MP I and MP II violates the debt limit laws—and that dispute is sufficient to sustain a claim for declaratory relief. In addition, the court erred by finding that SDCERS was not a proper defendant on such a claim because SDCERS is not a "city," when SDCERS plainly is part of the City, and the record unquestionably demonstrates that SDCERS approved the unfunded benefit increases at issue without same year revenue sources. Termination of underfunding by the *Gleason* settlement is irrelevant to the debt limit law violations, which focus on the ***creation*** of illegal debt.

d. The trial court abused its discretion in holding that the action could not proceed because necessary parties have not been joined. Because the thousands of pension beneficiaries (and the taxpayers) are represented by those already parties to the litigation, and because the sole issue is whether the government actions are void due to conflicts of interest, all necessary parties are joined. Moreover, joinder of the thousands upon thousands of individuals is impracticable, and they are not indispensable.

e. The trial court erred as a matter of law in holding that a remedy of remand to the City Council for new proceedings freed from the taint of conflict of interest is improper: That remedy is mandated by state conflict of interest law.

D. BASIS FOR RELIEF

14. This Court may issue a writ of mandate to a lower court "to compel the performance of an act which the law specially enjoins . . . ." Cal. Civ. Proc. Code § 1085. When a trial court abuses its discretion, or fails to follow the law, the issuance of a writ of mandate is proper. *See Bricker v. Super. Ct.*, 133 Cal. App. 4th 634, 638-39 (2005); *Babb v. Super. Ct.*, 3 Cal. 3d 841, 851 (1971); *Mannheim v. Super. Ct.*, 3 Cal. 3d 678, 685 (1970). Particularly where the operative facts are undisputed, and the sole question is one of law, a writ will issue to compel a correct order if discretion can legally be exercised in only one way. *Anchor Marine Repair Co. v. Magnan*, 93 Cal. App. 4th 525, 529 (2001); *Academy of California Optometrists, Inc. v. Super. Ct.,* 51 Cal. App. 3d 999 (1975). In issuing the Statement of Decision, the trial court abused its discretion and committed serious errors of law, causing severe prejudice and irreparable harm to the City, as described above. The basis for relief is set forth more fully in the attached

Memorandum of Points and Authorities, and is incorporated by this reference as though set forth fully herein.

E. <u>TIMELINESS OF PETITION</u>

15. A Proposed Statement of Decision was filed on December 14, 2006, and a final Statement of Decision ("Decision") was filed on January 18, 2007. Therefore, this Petition is timely filed.

F. <u>PERFECTION OF REMEDIES</u>

16. The arguments set forth herein were considered by the trial court in pretrial cross-motions for summary judgment or adjudication; in the proceedings on the Phase I trial; in the Proposed Statements of Decision lodged by both sides; and in the City's objections to the court's December 14 Proposed Statement of Decision.

G. <u>ABSENCE OF OTHER REMEDIES</u>

17. A statement of decision on only one phase of a trial does not result in entry of final judgment and is not an appealable order. The City therefore has no adequate remedy to correct the trial court's errors, other than this Petition.

H. <u>AUTHENTICITY OF EXHIBITS</u>

18. All exhibits accompanying this Petition are true and correct copies of original documents on file with Respondent Court. They are referenced by "Ex. __ at __," which corresponds to the exhibit number of the exhibits in support of this Petition and the corresponding consecutive bates number. The trial exhibit number or trial transcript citation is in parenthesis. The exhibits filed herewith are incorporated herein by reference as though fully set forth in this Petition.

III.

PRAYER FOR RELIEF

WHEREFORE, Petitioner prays that this Court:

1. Issue a writ of mandate or other appropriate writ relief directing Respondent Superior Court to vacate its January 18, 2007 Decision and to rule instead as follows:

   a. The trial court has jurisdiction to proceed under California Code of Civil Procedure Section 389 because all necessary parties are joined, or, in the alternative, it would be an abuse of discretion to decline to proceed because the absent parties are not indispensable;

   b. The City's claims regarding MP I are not barred by the *Corbett* settlement;

   c. The City's claims regarding MP I and MP II are not barred by the *Gleason* settlement;

   d. The City has stated a valid claim for relief against SDCERS under the state and City debt liability limit laws; and

   e. There is a justiciable remedy for violations of California Government Code Sections 1090 and 1092 and the debt limit laws, which is to void the illegal governmental actions and remand the matter to the City Council for proceedings untainted by conflicts of interest, to be followed, if necessary, by a validating action.

2. In the alternative, issue an alternative writ or order to show cause commanding Respondent to vacate its Decision, or show cause why it has not done so;

3. Award Petitioner the costs of this proceeding; and

4. Provide Petitioner with such other and further relief as this Court may deem proper.

Dated: January __, 2007

MICHAEL J. AGUIRRE, City Attorney

By______________________________
Michael J. Aguirre
City Attorney
Attorneys for Petitioner
CITY OF SAN DIEGO

MEMORANDUM OF POINTS AND AUTHORITIES

I.

INTRODUCTION

The trial court's Phase I Decision halts the City's case in its tracks and bars resolution of whether MP I and MP II created hundreds of millions of dollars in illegal public pension benefit debt in violation of Government Code Section 1090 ("Section 1090") and debt liability limit laws. Remarkably, as is shown below, the court did so because of judgments in two prior cases, ***neither of which raised (much less adjudicated) Section 1090 or debt limit law issues regarding MP I and MP II.*** Neither *res judicata* nor the court's amorphous "estoppel"/ratification concepts can prevent the City and its taxpayers from their day in court. By law, the only cure for the violations is to void the prior illegal actions, fully disclose the wrongdoing and adopt new, legal legislative measures—a process which unquestionably has not occurred and a remedy that the court inexplicably found insufficient.

The court also held that the case could not proceed because the very unions who bargained for and supported MP I, MP II, and the implementing agreements on behalf of all system beneficiaries do not represent those beneficiaries for purposes of considering whether those transactions were illegal. Under established principles of representational standing, however, the unions do represent the beneficiaries, and not every potentially interested party must be joined in litigation seeking a declaration of legal rights, especially litigation in the public interest.

Most troubling, the court's Decision readily admits that the public officials in question not only took official action that financially benefited themselves by increasing their own pension benefits, but they also enabled the benefit increases to occur by allowing the pension system (of which they were fiduciaries) to be underfunded—a *per se* violation of Section 1090 and the debt limit laws. Yet, by destroying any prospect of setting aside the hundreds of millions of dollars in illegal benefits, the court's decision casts the bulk of the illegal benefits in stone without ever deciding the illegalities. This abdication of judicial review is the antithesis of the objectives of the conflict of interest and debt limit laws—which universally void the consequences of illegal actions, and which do not tolerate the erection of technical, legal barriers to taxpayer relief.

II.

STATEMENT OF THE CASE

This lawsuit originally was filed by SDCERS on January 27, 2005, as a claim for declaratory relief and a preliminary injunction relating to the issue of the retirement system's legal counsel. In response, the City and San Diego City Attorney Michael J. Aguirre ("Aguirre") cross-complained against SDCERS, *et al.*, seeking, *inter alia*, a declaration that certain City employee retirement benefits are the result of illegal transactions and therefore void, and a writ of mandate barring further payment of those benefits.

The City currently has pending its Fifth Amended Cross-Complaint (5ACC), which asserts two separate causes of action for declaratory relief against SDCERS—the first seeks a declaration that MP I was illegal and void, and the second seeks a declaration that MP II was illegal and void. Ex. 1 at 00014-00016. The City's 5ACC asserts that certain government officials violated prohibited financial interest and debt limit laws when they developed and approved City employee pension benefit increases because (1) those officials stood to personally benefit from the increases, (2) the benefit increases were contingent upon allowing underfunding of the pension system the officials were duty-bound to protect, and (3) the debt created exceeded same-year revenues.[1]

In addition, on July 26, 2005, SDCERS filed a new action for declaratory relief, entitled *San Diego City Employees' Retirement System v. City of San Diego*, San Diego Superior Court Case No. GIC851286, seeking the opposite relief from that the City and Aguirre requested in their cross-complaint, *i.e.*, that the benefits were lawful and could continue to be paid.[2]

In August 2005, the unions representing City employees and SDCERS pension beneficiaries, including MEA, Local 127, and Local 145 (collectively, the "Unions"), filed complaints in intervention. Ex. 2 (MEA's Complaint in Intervention, filed August 10, 2005); Ex. 4 (AFSCME Local 127's Complaint in Intervention, filed on or about August 1, 2005). Over City opposition, the Unions were granted leave to intervene in support of SDCERS. The Unions' complaints in intervention seek, *inter alia*, a

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[1] The City relies upon prohibited financial interest laws set forth in California Government Code Sections 1090 and 1092 and San Diego City Charter Section 94. The City also relies upon debt limit liability laws contained in the California Constitution, Article XVI, Section 18, and San Diego City Charter Section 99.

[2] Subsequently, in support of its Motion for Summary Judgment, SDCERS clarified that it was not seeking a declaration that the benefits were legal but, rather, a declaration that SDCERS had paid and could continue to legally pay the benefits until such time as they were repealed or voided by the Court.

declaration that the benefit increases awarded under MP I and MP II, as well as implementing agreements and legislation, are lawful despite the alleged violation of state conflict of interest laws.

At about the same time the Unions intervened, former City Clerk Charles Abdelnour and numerous individual non-union employees and retirees filed a third lawsuit against the City entitled *Abdelnour, et al. v. City of San Diego,* San Diego Superior Court Case No. GIC852100, alleging one cause of action for declaratory relief, and requesting a judicial determination that SDCERS may legally pay all contested pension benefits. Ex. 3 (*Abdelnour* Plaintiffs' First Amended Complaint for Declaratory Relief, filed August 25, 2005). The *Abdelnour* case was consolidated with Case No. GIC851286, which was then consolidated with Case No. GIC841845.

In an order entered on September 15, 2006, and supplemented by a pretrial conference hand-out on October 26, 2006, the trial court granted the Unions' request for phased trial proceedings and divided the case into three phases, with the following issues to be heard in Phase I:

1. Whether the Fifth Amended Cross-complaint presents an actual and justiciable controversy between the City and necessary parties (relating to the indispensable parties issue);
2. Whether the Fifth Amended Cross-complaint presents an actual and justiciable controversy on which the Court can render a meaningful, concrete and specific decree (relating to the issue of what remedy is sought by the City and whether it is possible under the circumstances of this case);

3. Whether the City's claims that MP I and MP II are null and void are barred because of the *Gleason* settlement and litigation;

4. Whether the City can pursue a claim that SDCERS violated the Debt Limit Laws; and

5. Whether the City is estopped as a matter of law from challenging the MP I benefits by the prior judgment in *Corbett*.

Under the trial court's order, Phase II will address statute of limitations defenses and Phase III will determine all remaining issues, including the central questions relating to the allegedly invalidating conflicts of interest. Ex. 5 at 00078. For purposes of Phase I, the court assumed that a Section 1090 violation had occurred.

Trial on Phase I commenced on October 30, 2006, and concluded on November 29, 2006. The Intervenors had the burden of proof on each issue. Ex. 11 at 00336 (Decision at 2:27-28). At the request of the trial court, the parties each submitted Proposed Statement of Decisions. Ex. 6; Ex. 7. On December 14, 2006, the trial court issued its Proposed Statement of Decision, Ex. 8, and the City filed lengthy objections, Ex. 9. After a hearing on the City's objections, Ex. 10 (Reporter's Tr., Jan. 11, 2007), the trial court issued the Decision, Ex. 11.

In its Decision, the court ruled adversely to the City in almost every respect. Remarkably, the court did so ***despite its express recognition that the factual predicate for a violation of Government Code Section 1090 (prohibiting government action by those with a financial interest) was established by the evidence:***

> Several of the SDCERS board members, including Webster, Torres, Wilkinson, Saathoff, ***voting in favor of the proposal***

> ***were City employees whose retirement benefits were improved by the City's enactment of the new benefits***. The testimonial and documentary evidence established the ***City made the grant of enhanced pension benefits contingent on SDCERS approving the funding relief***.

See Ex. 11 at 00343 (Decision at 9:16-22) (emphasis added). In other words, as the court specifically found, the SDCERS Board members not only voted to increase their own pension benefits, but they enabled the City to increase those benefits by abdicating their fiduciary duties as the guardians of system funding, and permitting the underfunding on which the benefit increases were dependent to occur.

III.

STATEMENT OF FACTS

The relevant events are memorialized in the official record of the public proceedings underlying this litigation, which was introduced into evidence in the Phase I trial. Because this record demonstrates the magnitude of the errors made by the trial court, the consequences to the public interest, and the need for immediate writ review, it is reviewed in detail. As the trial court recognized, this record is replete with evidence showing not only that the SDCERS Board members voted their own benefit increases, but also that those increases were part of a "package" deal, in which the Board members allowed the City to underfund the pension system to influence the City to increase the benefits.

A. MANAGER'S PROPOSAL I

Former San Diego City Manager Jack McGrory and former SDCERS President Keith Enerson discussed the plan behind MP I at a February 26, 1996 meeting. Lawrence

Grissom, the former SDCERS Administrator, who also participated in the February 26, 1996 meeting, described the "package" in a March 1, 1996 draft memorandum. Ex. 12 at 381 (Ex. 50). The March 1, 1996 "package" memorandum discusses a plan to provide the City with "rate stabilization," by using SDCERS funds to "cover shortfalls in contributions" from the City to SDCERS. Ex. 12 at 00382 (Ex. 50.2). Under a heading entitled "Analysis" is a summary of the objectives of MP I, which included not only a provision to allow the City to pay less to the pension system, but also to fund more pension benefits:

> These actions set up the structure necessary to provide for rate stabilization, providing a reserve to protect the 13th check, payment of insurance premium costs, capturing some of the tremendous earnings we are currently experiencing, and, as will be discussed later, possibly funding some additional benefits.

Ex. 12 at 00382 (Ex. 50.2). The memorandum discussed "three drawbacks to this approach":

> 1. Perception. It looks like the Board is "giving" the City a lot of money. This is, frankly a political and negotiation issue. The negative perception should be at least partially offset by increasing benefits as discussed below.
>
> 2. Outside counsel. I have no idea whatsoever how outside counsel will react to this plan. We should consider this carefully and thoroughly strategize our approach.
>
> 3. Holding Stabilization Reserve outside valuation assets. The net effect is to increase the System's unfunded liability.

Ex. 12 at 00382 (Ex. 50.2).

Under the outlined plan, the City's contribution to the pension system between Fiscal Years 1996 to 2000 would be at set percentages of payroll, rather than determined by the SDCERS actuary. The City's proposed reduced rates and corresponding savings were set out as follows:

Period	PUC Rate FY 96 EAN Rate FY97+	Rate to Pay	Difference %	Difference $
FY96	8.6%	7.08%	1.52%	$5.65
FY97	10.20%	7.33%	2.87%	$11.16
FY98	10.20%	7.58%	2.62%	$10.64
FY99	10.20%	8.20%	2.00%	$8.42
FY2000	10.20%	8.20%	2.00%	$8.86

Ex. 12 at 00384 (Ex. 50.4). The memorandum also discussed benefit improvements proposed as part of the plan. Ex. 12 at 00386-00387 (Ex. 50.6-7).

A written version of MP I was presented by Jack McGrory at a Special Meeting of the SDCERS Board held on May 2, 1996. At that meeting, the then-City Manager,

> Mr. McGrory stated that it has become difficult for the City to work with the System's fluctuating rates. ***In exchange for benefits improvements contained in the proposed package, he stated that the City needs help with the Earnings Stabilization Reserve***.

Ex. 13 at 00389 (Ex. 276.2) (emphasis added).

Attached to the SDCERS Board Meeting Minutes for that date is the Manager's Proposal dated May 2, 1996. In the "Concept Overview," the Manager (McGrory) addressed benefits and funding issues:

> It is the City Manager's intent to recommend changes to the City Employees Retirement System related to: (1) retiree health insurance, (2) retirement plan benefits, (3) employer contribution rates and calculation method, and (4) retirement system reserves. These proposed changes to plan benefits, retiree health insurance, employer rate calculations and system reserves will require approval of the City Council [and] CERS Board of Administration . . . . ***The***

> ***interrelationship of these various issues to each other necessitate that the entire proposal be considered and acted upon concurrently.*** Furthermore, the substantial financial implications to the City compel that certain actions occur in time for Fiscal Year 1997 budget decisions.

Ex. 13 at 00393 (Ex. 276.6) (emphasis added). The proposal then describes the benefit increases, including the increase in the General Member benefit formula. *Id*. at 00395 (Ex. 276.8). Attached to the proposal are summary tables, which show both the City contribution rate relief and the benefit increases. *Id.* at 00398-00403 (Ex. 276.11-276.16). That outline also reflects the need for SDCERS Board approval. *Id.* at 00413 (Ex. 276.26).

Unions representing the City workers joined in the discussions of the proposed rate stabilization plan. On May 17, 1996, MEA lawyer Ann Smith sent a letter proposing that the General Member benefit formula be increased from the 1.75% at age 55 (proposed by Manager McGrory in his May 2, 1996 presentation) to 2.24% at age 55. Ex. 14 at 00629-00630 (Exs. 87.1-87.2). In her May 17 letter, entitled "MEA's PROPOSAL FOR RESOLUTION OF RETIREMENT SYSTEM ISSUES AND CONTRACT EXTENSION COVERING FY98," Ms. Smith wrote:

> I also cannot over-emphasize that the level of employee scepticism [sic] and distrust regarding ***any tampering with funding methods*** related to the retirement system is enormous and will require a yeoman's effort by every person associated with MEA to overcome. ***MEA will not undertake this formidable task unless the gains in benefit levels for the employees MEA represents are clearly respectable*** and credible rather than <u>de minimus</u> [sic]. Frankly, at this juncture, the proposal to increase the general member's formula from 1.48% to 1.75% at age 55 is <u>de minimus</u> when

> contrasted with a proposed safety formula of 3% at age 55 and 2.74% at age <u>50</u>.

Id. at 00629 (Ex. 87.1) (italics added).

Manager McGrory subsequently revised his proposal to increase the general member formula to 2.0% at 55. He also changed the proposal to extend the "rate stabilization" (*i.e.*, underfunding) period to 2008. The City Manager circulated the revised proposal on June 7, 1996. Ex. 13 at 00480 (Ex. 276.93). Again, that proposal stated that the benefits and funding terms were both part of the plan: "It is the City Manager's intent to recommend changes to the City Employees' Retirement System related to: (1) retiree health insurance, (2) ***retirement plan benefits***, (3) ***employer contribution rates***, and (4) retirement system reserves." Ex. 13 at 00480 (Ex. 276.93) (emphasis added). This would require the approval of "the City Council [and] CERS Board of Administration . . . ." *Id.* at 00480. The Proposal states:

> ***The interrelationship of these various issues to each other necessitate that the entire proposal be considered and acted upon concurrently***. Furthermore, the substantial financial implications to the City compel that certain actions occur in time for Fiscal Year 1997 budget decision.

Id. at 00480 (emphasis added).

The Proposal then describes the multiple benefit increases that will be afforded to the employees, including an increase in the General Member benefit formula. *Id.* at 00481 (Ex. 276.94). The benefit increase imposed substantial past liability, which would be paid for with the funds already in the system. *Id.* at 00482 (Ex. 276.95). As part of this agreement, along with the increase of benefits (granted without new funding), the

City's Employer Contribution Rates were reduced markedly. *See id.* at 00484 (Ex. 276.97). In some years, the City's contribution would decrease 3% to 4%, for a total decrease in funding obligation over the life of the agreement of $110.35 million. *Id.* Rather than the actuarially-calculated rate, the City would pay the "agreed rate" from FY1996 to FY2007, and the difference between the two would be funded out of the Stabilization Reserve, *i.e.,* out of monies already in the system. If the amount in that reserve became insufficient, or the funded ratio fell more than 10% below the funded ratio calculated at the June 30, 1996 valuation (the 82.3% "trigger"), the plan would sunset the following year. *Id.* at 00485 (Ex. 276.98).

On June 11, 1996, the SDCERS Board held a "Special Workshop" relating to the Manager's Proposal. The Workshop minutes confirm that the "plan" was the subject of discussions between the City Manager's office and the unions, as well as the SDCERS Board:

> [Mr. McGrory] indicated that the Manager's office had been discussing all of the aspects of their proposal with the employee groups and seeking their concurrence with the plan.

Ex. 13 at 00454 (Ex. 276.67). Mr. McGrory made clear that the plan included a substantial increase in a variety of benefits, and "assist[ance to] the City in stabilizing their contribution rates." *Id.* at 00455 (Ex. 276.68). The City's contribution would be "stabilized" by using the system's reserve funding to offset the cost of benefit increases, and to fund a portion of the City's necessary contribution rates. *Id.* at 00456-00457 (Ex. 276.69-276.70). The concept, stated simply, was to use the system's reserves, which had grown due to investment successes in recent years, to fund both benefit increases and City contributions. *Id.* at 00460 (Ex. 276.73). *See also id.* at 00464 (Ex. 276.77).

Under the new version of MP I, the rate stabilization period was extended from Fiscal Year 2000 to Fiscal Year 2008:

Employer Contribution Rate Stabilization Plan

Period	PUC Rate	City Paid Rate	Difference %	Difference $
FY96	8.60%	7.08%	1.52%	$5.33m
FY97	10.87%	7.33%	3.79%	$13.88m
FY98	12.18%	7.83%	4.35%	$16.67m
FY99	12.18%	8.33%	3.85%	$15.40m
FY2000	12.18%	8.83%	3.35%	$14.00m
FY2001	12.18%	9.33%	2.85%	$12.45m
FY2002	12.18%	9.83%	2.35%	$10.72m
FY2003	12.18%	10.33%	1.85%	$8.82m
FY2004	12.18%	10.83%	1.35%	$6.73m
FY2005	12.18%	11.33%	.85%	$4.43m
FY2006	12.18%	11.83%	.35%	$1.91m
FY2007	12.18%	12.18%	-0-	-0-
FY2008	13.00%	13.00%	-0-	-0-
TOTAL				$110.35*

*$110.35 million paid from excess earnings includes $17.31 million in contributions as a result of benefits improvements recommended herein.

Ex. 15 (Ex. 155.10).

The discussion, as recorded in the SDCERS Meeting Minutes, reflects that this was a "package" deal:

> Mr. Barnett asked if this is being presented as a complete "take-it" or "leave-it" package.

> Mr. McGrory responded that . . . this is a comprehensive approach.

Ex. 13 at 00462 (Ex. 276.75).

Mr. McGrory observed in closing,

> that he believes that these two bodies [the Manager's Office and the Board], ***along with the employee organizations***, have developed an acceptable plan that will solve the City's short and long term problems with the System . . . .

Id. at 00465 (Ex. 276.78) (emphasis added).

The system's actuary also presented his conclusions at this Board meeting. He said that "from a technical standpoint," to fund the new benefits that are part of this proposal, "there would be approximately [an] $80 million [liability] which will have the [i]mpact of a 5% reduction in whatever the funding ratio would be at that point." *Id.* at 00465-00466 (Ex. 276.78-276.79). *See also id.* at 00468 (Ex. 276.81) ("the funded ratio would drop by 5%").

Several Board members recognized the impact of the benefit increases on future generations of taxpayers. First,

> Ms. Jamison stated that the City's contribution rates would be increasing over time and that the curve, relative to what it would have been, is going to decrease at some point. She questioned whether future tax payers would be placed in a position of having to pay for these benefit increases if they are adopted . . . .

Id. at 00468 (Ex. 276.81). Another Board member took up the same issue:

> Mr. Casey stated that there is an underlying statement in the Charter that indicates that today's service credit must be paid for by today's taxpayers. He stated that this proposal gives

> him the distinct impression that future taxpayers will be paying for these benefit increases . . . .

Id. at 00469 (Ex. 276.82). Mr. Casey further stated:

> [I]f this proposal is implemented, he has concerns that the younger generation will be expected to pay retirement benefits for today's generation. He stated that he does not believe this is appropriate.

Id. at 00469. The system's actuary agreed:

> Mr. Roeder responded that there is no question that the rate that is being agreed upon is less than what he considers to be the "ivory tower" actuarial rate over the next ten years. Therefore, some of these costs will be borne by the future generation.

Id. at 00469.

Fiduciary counsel to the Board, Mr. Hamilton, thought the agreement raised "red flags" regarding the Board's duty to the pension system itself:

> ***He stated that there were "red flags" raised in his mind by this proposal as it relates to the Board's duty of loyalty to the integrity of the fund*** . . . .

Ex. 13 at 00471 (Ex. 276.84) (emphasis added). Further,

> [h]e reminded the Board that the pension beneficiaries and members have a vested right to an actuarially sound system and that ***the Board has a duty of loyalty to the integrity of the fund that can not be contracted away***.

Id. at 00473 (Ex. 276.86) (emphasis added).

Another Board member, Ms. Parode, echoed this point, stating that "current employees would be excited about receiving improved benefits," and therefore it was the fiduciaries' duty to be "concerned about the long-term funding of the System." *Id.* at 00476 (Ex. 276.88). "[S]he questioned how far unfunded a system can become before becoming susceptible to a challenge on the Board's management of the fund." *Id.* at 00475. Mr. Hamilton responded that "the liability of current employees/retirees are [sic] being transferred to future taxpayers." *Id.* at 0045.

Another Board member, Ms. Wilkinson, stated that "[g]iven the 'red flags' raised today, she questioned whether Mr. Hamilton would recommend that the Board vote on this issue at their 6/21/96 meeting." *Id.* at 00476 (Ex. 276.89). Mr. Hamilton responded:

> [T]his would depend on how quickly these issues can be resolved. If all of the parties can come to an agreement, he stated that he does not forsee [sic] a problem.

Id. at 00477 (Ex. 276.90). The Chair, Mr. Enerson, concluded by stating that "he would like to plan for success." *Id.* at 00477 (Ex. 276.90).

The revised June 7 Proposal was amplified in a memorandum to the SDCERS Board from Manager McGrory dated June 21, 1996. The memorandum made specified changes to the June 7 Proposal. Ex. 16 (Ex. 43). McGrory again made clear that there was one deal: "These benefit changes . . . are presented as part of the overall proposal." Ex. 16 at 00668 (Ex. 43.2). The memo modified the sunset provision to make clear that the new benefits are an integral part of the funding calculation—indeed, the benefits are accounted for in the actuarial valuation sunset provision adopted by the Board. *Id.* at 00668 (Ex. 43.2). As for Past Service Liability:

> The proposed restructuring provides for an increase in the formula for calculating benefits . . . . This increases the cost to the System to pay the benefit, ***which increases liabilities since no contributions have been received in the past to fund the benefit at this level***. This is what is known as past service liability. The actuary has estimated the amount of

> past service liability created by the restructuring proposal to be $76.7 million expressed in 1996 dollars.

Id. at 00669 (Ex. 43.3) (emphasis added).

Under the "restructuring," neither these past benefits nor the future benefits are funded at the actuarially recommended rate. Rather,

> [t]he restructuring proposal provides that the employer contribution rate will be "ramped up" to the actuarially recommended rate in increments over the next 10 years. ***This means that the System will be receiving less in contribution dollars over that period, which creates an additional liability***.

Id. at 00669 (Ex. 43.3) (emphasis added).

The combination of benefit increases and reduced contribution had a significant fiscal impact: "The actuary has estimated the amount of contribution shortfall liability created by the restructuring proposal to be $30.0 million expressed in 1996 dollars." *Id.* Thus, the "***increased liabilities associated with the restructuring proposal [are] in the amount of $106,700,000***." *Id.* at 00669 (emphasis added).

Finally, the memo concludes:

> TOTALITY OF THE PROPOSAL
> If the necessary contingencies identified to approve this Proposal in its entirety are not affirmatively met by January 1, 1997, then:
> . . .
> B. The CERS benefit improvements listed in Issue No. 2 above would not occur;
> C. The employer contribution rates to be paid would be those established by the System's Actuary.

Id. at 00670 (Ex. 43.4).

On the same day as this memorandum was issued, June 21, 1996, the SDCERS Board met to consider the Proposal. Ex. 13 at 00505-00541 (Ex. 276.118-276.154) (SDCERS Board Meeting Minutes 6/21/96). The Board's Agenda Item addresses both contributions and benefits: "CITY MANAGER'S PROPOSALS REGARDING CONTRIBUTION RATES, BENEFITS AND DISTRIBUTION OF EARNINGS." *Id*. at 00516 (Ex. 276.129). The Minutes reflect that: "Mr. McGrory reported that after extensive discussions with members of the Board, employee organizations, a series of fiduciary counsels, and the System's actuary, the draft Manager's proposal has come back to the Board with recommended benefits improvements . . . ." *Id*. at 00516 (Ex. 276.129). Mr. McGrory concluded his remarks to the Board by discussing the funding for the restructuring, and then making clear that the employee benefit increases were wholly contingent on the Board's approval of this complete "package":

> He reminded the Board that this must be treated as a package. ***If this is not approved, he stated that come January, 1997 the City would repay the contribution rate gap for 1996 and 1997, and none of the benefit improvements would occur.***

Id. at 00518 (Ex. 276.131) (emphasis added).[3]

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[3] As the actual transcript of the June 21, 1996 SDCERS Board meeting reflects, Mr. McGrory's full statement to the Board on this point was as follows:

> And again this is a package. What we are asking you to do today is to adopt the budgeted rate that we have for fiscal year 1996, this fiscal year, adopt the rate that we have recommended in our package for fiscal year 1997, that this has to be treated as a package. And if the benefits in the package as a total is not approved, then we would then repay the contribution rate gap for [19]96 and [19]97 in January

This presentation was followed by a Motion to Approve the City Manager's Proposal dated June 21, 1996. *Id.* In the ensuing discussion, Board Member Paul Barnett asked whether fiduciary counsel, Mr. Hamilton,

> was troubled by the fact that the Board would be agreeing to allow the System to remain under-funded by a considerable amount and using the system's surplus to help pay for additional benefits and assisting the employer with their contributions rates.

Id. at 00520 (Ex. 276.133). Mr. Hamilton responded by saying that "he would like to address the package as a whole" "[b]ecause this is being presented as a comprehensive package . . . ." *Id.* at 00520. He indicated that the Board has a fiduciary duty to determine the appropriate funding level deemed necessary to provide for the additional benefits. *Id.* at 00520. He further stated "that there needs to be something in this proposal that would assist the City" and therefore "the question is whether the contribution rate stabilization plan as advocated by the City Manager, is something that the Board can live with . . . ." *Id.* at 00521 (Ex. 276.134).

In response to a question from Board Member Wilkinson, Mr. Roeder, the system actuary, confirmed that the proposal would result in an immediate "5% drop in the [System's] funding level because . . . the System will immediately recognize approximately $77 million in accrued liabilities related to the increased benefits for past service." *Id.* at 00527 (Ex. 276.140).

> 1997 and none of the benefits would take place, none of the benefits improvements. So the entire package would unwind.

Ex. 17 at 00684 (Ex. 271.2, Track 5 (6/21/96 SDCERS Board Meeting Transcript) and Ex. 1082.1 (audio excerpt)).

"Since . . . the City Manager has indicated that this is one integrated, 'take-it' or 'leave-it' package," Ms. Wilkinson questioned what action the Board could take on this proposal that day. *Id.* at 00528 (Ex. 276.141). The Chair, Mr. Enerson, confirmed that the City Manager "has presented this proposal as a package deal." *Id.* at 00528. The System Administrator, Mr. Grissom, advised that the Board had the "authority to make a determination in agreement with the City on how the rates will be paid." *Id.* at 00530 (Ex. 276.143).

The Board also heard testimony from union representatives, urging the Board to approve this proposal "as a means to allow the general member's benefit levels to be increased . . . ." *Id.* at 00534 (Ex. 276.147).

Part of the record of this Board proceeding is the opinion of the Board's fiduciary counsel. In a letter dated June 21, 1996, counsel notes that the liability to the system created by the past service liability will be $76.7 million, plus $30 million in contribution shortfall liability:

> No contributions have been received in the past to fund the increased benefits, and thus the result is an increased liability [of $76.7 million]. The City Manager's Employer Contribution Rate Stabilization Plan provides for the employer contribution rate to be incrementally increased to the actuarially recommended rate over the next ten years. As a result, the System will be receiving less in contribution dollars over that period, which creates an additional liability. The actuary estimates that the amount of contribution shortfall liability created . . . is $30 million expressed in 1996 dollars.
>
> The total of estimated increased liabilities associated with the City Manager's proposals is $106,700,000 . . . .

Ex. 13 at 544-545 (Ex. 276.157-276.158).

Finally, another letter from fiduciary counsel linked the benefits increases and the underfunding: "The modification and increase of benefits, as set forth in Issue No. 2 of the City Manager's proposal . . . ***is contingent upon*** the Board's approval of Issues No. 3 and 4 [relating to funding]." Ex. 18 at 692 (Ex. 84.5) (emphasis added).

At the conclusion of the June 21, 1996 SDCERS Board meeting, the Board passed the Manager's Proposal, now known as MP I, by an 8-3 vote, with SDCERS Board Members Terri Webster, Sharon Wilkinson, Ron Saathoff and John Torres providing the swing votes in favor of MP I. *Id.* at 535 (Ex. 276.148). These individuals were also City employees and direct beneficiaries of the benefit increases in the proposal, in direct violation of conflict interest laws such as Section 1090. *Id.*[4]

On July 2, 1996, the City Council passed Resolution No. 287582, adopting the Manager's Proposal. Ex. 15 (Ex. 155). That Resolution reflects that the unions agreed that the proposed benefit increases were "subject to the occurrence of various contingencies contained within the proposal." Ex. 15 at 633 (Ex. 155.1). The resolution was "contingent on an affirmative vote of the participants." Ex. 15 at 634 (Ex. 155.2). Each of the Management Proposals to the unions was thereby conditioned upon the

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4 As the trial court notes, this approval of underfunding based upon benefit increases reflected a change in the Board's prior stance. Ex. 11 at 341 (Decision at 7:6-9) ("the City's proposals to reduce pension contributions made in the years before 1996 had been rejected by the SDCERS board. These past efforts had been made without a proposal for benefit improvements").

union's and beneficiaries' acceptance of the Manager's Proposal to SDCERS. *See* Ex. 15 at 644, 652 (Exs. 155.12, 155.20).

In short, the record of proceedings demonstrates that MP I was a "package" deal, in which benefit increases were tied to funding concessions. The benefit increases in the implementing legislation and Memoranda of Understanding ("MOUs") were part of an integrated plan developed by certain City officials, which was contingent upon the funding relief provided by the SDCERS Board. The direct beneficiaries of the resulting City employee benefit increases were the City employees who developed and implemented the plan, including the four SDCERS Board Members who cast deciding votes in favor of the deal. The agreement allowed a drastic reduction in the City's funding of the pension system, including years of employer contributions below the actuarially-required rate.

B. MANAGER'S PROPOSAL II

The underfunding seeds planted in MP I bore bitter fruit as the economic boom years of the mid-1990s (which had created the cushion available to fund the benefit increases and "contribution stabilization" in MP I) were succeeded by the events of September 11, 2001, the bust of the dot-com stock market and shortfalls in state funding. These events, and the resulting downward spiral in system funding, which threatened to "trigger" a City balloon payment, led to MP II, a second Manager's Proposal, in 2002. The official record shows that MP II again involved increased benefits coupled with funding reductions. The record also shows that it was virtually the same group of

SDCERS Board members and City officials who developed, approved, and implemented MP II.

On or about June 10, 2002, the City Manager proposed that MP I be modified to establish a 75% floor for the actuarial funded ratio of SDCERS—a further decrease below the 82.3% "trigger" adopted in MP I. Ex. 13 at 566 (Ex. 276.179). This ***decrease*** in funding requirements was to be coupled with another ***increase*** in the General Member benefit rate. Ex. 13 at 566 (Exs. 276.179); Ex. 19; Ex. 40 (Ex. 274); Ex. 39 (Ex. 311); and Ex. 30 (Ex. 357). The unions again were participants in the process. For example, the letter of May 13, 2002, from the City's labor negotiator, Dan Kelley, to union president Judith Italiano states:

> Substantial benefit improvements granted by the City since the adoption of the "City Manager's Retirement Proposal" dated July 23, 1996 (Manager's Proposal) have created additional unfunded liability to SDCERS that was not anticipated when the City agreed to the "trigger" provisions.

Ex. 19 at 00696 (Ex. 272.2). Further,

> [s]ignificant improvements in benefits are contained in this three-year proposal. Consequently, the "trigger" provisions must be adjusted as a condition of the City's three-year proposal. Therefore, this three-year proposal is ***contingent*** upon, and subject to, approval by the SDCERS Board of Trustees of an adjustment to the "trigger" provisions contained in the Manager's Proposal, Issue #3, Paragraph B . . . .

Id. (emphasis added).

The original MP II plan was modified in a June 18, 2002 City Manager's Memorandum. Ex. 13 at 00566 (Ex. 276.179). The revision was in reaction to the draft opinion of the system's fiduciary counsel, Robert Blum, "***that if the Board adopted the Manager's proposed amendment of June 10, it may create a material risk that a court may consider such an approval not a prudent exercise of the Board's fiduciary responsibilities***." Ex. 13 at 00574 (Ex. 276.187) (emphasis added). To address that concern, the City offered to double the incremental increases in the agreed to City contribution rates beginning in fiscal year 2005. *Id.* at 01437 (Ex. 1350.1).

On June 21, 2002, the SDCERS Board took up the revised Manager's Proposal. Ex. 13 at 00566 (Ex. 276.179). The Deputy City Manager, Bruce Herring, presented

> his proposal . . . in the context of some labor negotiations that were recently completed with most of the City's employee labor representatives. What [Herring] is presenting today are the implications of these negotiations as they relate to the System and its funding trigger. Although they are separate issues, they are tied into the tentative labor agreements.

Id. Similarly,

> Mr. Grissom reported that these issues evolved out of the meet and confer process [between the City and the unions], in which a number of ***benefit enhancements were agreed upon, but made contingent upon the Board's approval of the Manager's funding proposal*** . . . . ***What the City is asking the Board to do is approve*** . . . ***a funding mechanism that would allow these benefit enhancements to be conferred.***

Id. at 00567 (Ex. 276.180) (emphasis added).

This prompted the System's actuary, Mr. Roeder, to express caution regarding the conflict of interest issue ***because benefits and funding should be separate***:

> He offered a long-term perspective of what's been happening over the past ten years. In isolation, there is nothing wrong with enhanced benefits, which people tend to favor. There is also nothing wrong with contribution relief—in isolation.

> However, when enhanced benefits come at the same time as contribution relief, the Board must be cautious. The Manager's Proposal has been in effect for five years, which has allowed the City to pay less than the actuarially assumed rate. ***The role of a fiduciary must be independent of the setting of existing or potential benefits. He can only urge that in the future, those two functions be truly segregated***.

Id. at 00567 (Ex. 276.180) (emphasis added). Mr. Roeder also pointed out that the City is the only public employer in the state to use the less conservative PUC actuarial funding methodology, and he warned that

> SDCERS has one of the lowest funded ratios in California. The gap between the PUC actuarial rate and the City's contribution has also increased and is now bigger than it was when the Manager's Proposal [I] was implemented.

Id. at 00568 (Ex. 276.181). Mr. Roeder also stated:

> He is concerned with the new proposal ***because of the coupling of benefit increases to funding***, along with the significant change from the 82.3% safeguard to 75%.

Id. at 00569 (Ex. 276.182) (emphasis added).

Fiduciary counsel, Mr. Blum, echoed Mr. Roeder's warnings:

> [He] said the proposal posed a material risk if this were litigated in court. ***The judge could find that approval of the proposed amendment to the 1996 Proposal was not a prudent exercise of the Board's fiduciary duties***, which would be based on the facts before the Board and fiduciary counsel at that time. In 1996, the Board agreed to an annual contribution rate that the City would make, which would in fact be lower than required under the actuarial valuation, using PUC . . . .
>
> Today, there is a different actuarial and economic situation. Mr. Blum said the actuary has told a very different story today than what the Board heard with the 1996 proposal. At that time, part of the benefits and contribution rate changes were approved, based on the fact the System had $105 million

> in surplus earnings . . . . Currently he and Ms. Hiatt are concerned about the lack of process the Board has undertaken at this point. ***In a worse case scenario, the Board and City could be sued*** . . . . ***If this were to happen, a number of things could occur. The judge could tell the Board anything from reconsidering its action all the way up to holding each Trustee personally liable for losses*** . . . . It is process that will get the Board out of the awkward position it has been put in. Similarly, this process will get the City and its employees out of this awkward position.
>
> . . .
>
> This requires appropriate review of the materials and ensuring that appropriate funds are contributed to SDCERS. ***The Board must also decouple negotiations and fiduciary decisions. One of the reasons this is such an awkward situation is that these two things have been brought together, which is very unfortunate*** . . . . The fact this year's proposal was coupled with negotiations was quite inappropriate. ***The Board's job is to administer the fund to the best of its ability and set standards, not to negotiate benefits***.

Id. at 00574-00567 (Ex. 276.187-276.189) (emphasis added).

After this discussion, and a question about whether the City could indemnify the Board if the Board breached its fiduciary duty, the motion to approve the proposal was amended to trail the item, and to hold a special meeting for the trustees to submit their concerns to staff. *Id.* at 00570 (Ex. 276.192). The Board then voted to continue the matter. *Id.* at 00582 (Ex. 276.195).

A subsequent City Memorandum, dated July 3, 2002, supplemented the Manager's Reports dated June 10 and June 18. Ex. 38. Included with that memo as Attachment 1 were answers to the Board members' questions. Trustee Richard Vortmann asked "the Manager to explain ***why the Board was put in the middle of labor negotiations***, and how we will conduct union negotiations in the future differently to prevent this inappropriate situation." *Id.* at 001439 (Ex. 1350.3) (Question 2) (emphasis added). The answer given in part confirmed that the Board ***was*** the lynchpin in enabling the benefit increases by allowing the underfunding to continue (and increase):

> Aware of the effect of the market decline and reduced SDCERS earnings during FY2002, the City developed concerns about a further decline in the funded ratio for the June 30, 2002 valuation and became concerned about the effect of "triggering" the full actuarial rates in FY04 contemplated in the 1996/97 Manager's Proposal.
>
> The City, through labor negotiations, agreed that the 2.50% at age 55 [increase] is an appropriate benefit to bestow. The City, however, was not willing to grant this benefit, given the cost, if at the same time, it might be facing a jump in retirement contribution which would further modify the rates to full actuarial rate (+$25 million) as a result of the "trigger." Consequently, the City agreed ***contingent*** upon the resolution in this proposal.

Ex. 38 at 01440 (Ex. 1350.4) (emphasis in original).

The City Council was kept apprised of the MP II-related developments at the SDCERS Board. By a July 8, 2002 memorandum, entitled "Contingent Retirement Benefits and Proposal to SDCERS," the City Council was informed that "[t]he 'draft' report from fiduciary counsel published for the June 21, 2002, meeting was quite negative . . . ." Ex. 21 at 00746 (Ex. 277). The Council was further informed that staff (Cathy Lexin) "anticipate a motion from a board member which would further modify the proposal before the Board, by eliminating the request to lower the funded ratio floor, and including the five year phase in if the trigger (82.3% funded ratio) is effectuated." *Id.* at 00747 (Ex. 277.2). Lexin "recommended that the Council authorize staff to agree to this modification should the proposal currently before SDCERS not prevail." The Council was further informed that "the practical impact on the City would be no different that the previously authorized City position. Under either scenario, there would not be any increase to the City contribution rate until FY05." *Id.*

On July 9, 2002, the City Council, in closed session, authorized city staff to accept the modified version of the MP II proposal "but only as backup if original proposal (75% trigger) fails at Retirement Board." Ex. 22 at 00748 (Ex. 373).

On July 11, 2002, MP II again came before the SDCERS Board for approval. As predicted in the July 8, 2002 memorandum, a SDCERS Board Member, Ron Saathoff, made a substitute motion that further modified the proposal before the Board by eliminating the request to lower the funded ratio floor, but including the 5-year phase in if the trigger was hit. Ex. 13 at 00621 (Ex. 276.234).

In the Board Minutes, *id.* at 00590 (Ex. 276.203), Mr. Grissom confirmed at the outset the link between the Board's action and the benefit increases:

> He explained that during this year's meet and confer process, the City and Labor Organizations agreed to some ***benefit enhancements which were subject to the Board's approval of a modification of the 1996-1997 Manager's Proposal***.

Id. (emphasis added). A lengthy discussion ensued during which then-private attorney Michael Aguirre advised the Board that the connection between the underfunding and the benefits placed the Board in an impermissible conflict of interest situation. *Id.* at 00609 (Ex. 276.222).

On the other side, Ann Smith, representing the MEA, supported MP II, saying that it "is an important part of MEA's analysis to seek benefit improvements which includes doing its own analysis, to retain its own advisors regarding the City's budget," to protect the represented employees. *Id.* at 00610 (Ex. 276.223). She stated: "Having reviewed the Manager's proposal, ***MEA has confidence in the integrity of what is being presented***." *Id.* (emphasis added). "She [assured] the Board that its support for the Manager's proposal is important to 5,000 represented employees. MEA has confidence with its analysis that this is an appropriate proposal." *Id.*[5] Another union representative, Ed Lehman, spoke in support of MP II, as well. *Id.*

In response to an objection that this proposal tied underfunding to benefits, Ms. Lexin invoked the MP I precedent, observing that there

> ***were substantial retiree and active member benefits tied to the 97 MP [MP I] and consideration was given to the employer that all three occurred at the same time and contingent upon each other.***

Id. at 00613 (Ex. 276.226) (emphasis added).

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[5] Contrary to Ann Smith's statements to the Retirement Board, Judith Italiano, former MEA President, testified at trial that MEA did not conduct any independent analysis regarding the feasibility of the City Manager's proposal. *See* Ex. 23 at 00788 (Tr. Nov. 7, 2006 p.m. 76:6-20) ("Q. All right. Now, did you do something in 2002 to determine . . . whether that proposal would, in fact, achieve . . . the actuarial funding of the system? . . . A. We attended any meetings where they were discussed, we listened to the presentations that were made by the City. ***We did not do any independent checking on what was being presented, no***.") (emphasis added); *see also id*. at 00789 77:14-22 ("Q. Okay. But – would it be also fair to say that with regard to any of this, the analysis that Mr. Herring was presented, and the feasibility of it, there was no independent analysis done by M.E.A. with regard to those representations? A. No, he – no. The City did their own analysis. Q. But – but ***would it be fair to say the M.E.A. did not do their own? A. We did not***.")

A Motion was made to support the Proposal. *Id.* at 00614 (Ex. 276.227). In the Board's second discussion, the actuary (Mr. Roeder) noted:

> [He] was more comfortable with the original proposal [MP I] because there were some safety nets that provided enough confidence that if hard times hit, the funding integrity of the System would not be negatively impacted. However, times are much different now. ***As such, he can't give the Board assurance today***.

Id. at 00614-00615 (Ex. 276.227-276.228) (emphasis added). The Motion to Approve the Manager's Proposal was then amended, ***to make Board approval contingent upon receiving "acceptable, written confirmation from the City that it would indmenifiy [sic] trustees in any lawsuits arising out of actions being taken by this Board***." *Id.* at 00617 (Ex. 276.230) (capitalization omitted) (emphasis added).

Fiduciary counsel, Mr. Blum, then restated his opinion as to the June 18, 2002 proposal, as to whether counsel "thinks the Board would be sued if the proposal were approved." *Id.* at 00619 (Ex. 276.232). "***His response is, yes, there is a material risk that the court could find that the Board didn't fully exercise its fiduciary responsibilities in approv[ing] this***." *Id.* (emphasis added).

After this advice, Board Member (and union president and City employee) Ron Saathoff brought the anticipated substitute motion in lieu of the June 18 Manager's Proposal. Mr. Saathoff moved to modify MP II to provide for an incremental payment schedule once the 82.3% trigger was hit, and other terms, which would include the benefit increases, all contingent upon a satisfactory written agreement between the City and the Board. *Id.* at 00621 (Ex. 276.234).

Although hesitant to provide an "on the fly" opinion, Mr. Blum proceeded to do so, saying he was "much more comfortable" with this motion. *Id.* at 00626 (Ex. 276.239). With little further discussion, the Board approved the modified proposal. *Id.* The Board voted 8-3 in favor, passing the motion, with Saathoff, Vattimo, Wilkinson, Torres, Webster and Lexin voting in support. *Id.* These Board Members, whose votes allowed passage of MP II, were all City employees and direct (and special) recipients of the benefit increases provided as part of the package, again contrary to the express proscriptions of Section 1090.

On October 21, 2002, the City Council approved a resolution adopting the "Presidential Benefit," allowing the handful of employees who served as union presidents—one of whom was Mr. Saathoff—to receive pension benefits based upon their union salary, in addition to any City salary, Ex. 24 (Ex. 61 (Res. No. 297212)), and adopting the MOU with the unions, which was contingent upon funding relief by SDCERS. Ex. 25 (Ex. 73 (Res. No. 297213)).

On November 15, 2002, the SDCERS Board approved the final terms of the MOU with the City. On November 18, 2002, the former City Council approved the resolution confirming the indemnification of the SDCERS Board Members. Ex. 26 (Ex. 108 (Res. No. 297335)). That same day, the Council approved the resolution authorizing the City's agreement with SDCERS on MP II, as previously approved by the Board. Ex. 27 (Ex. 1168 (Res. No. 297336)).

Finally, two Ordinances were passed, amending the Municipal Code. The first, Ordinance No. 19121, adopted November 18, 2002, implemented the SDCERS/City

MOU and provided that the Municipal Code would be amended (in Section 24.0801) to provide that the City's contributions to the Retirement System will be based upon the terms of the Memorandum of Understanding between the Board and the City, rather than the previous Municipal Code section that required actuarially-approved funding. Ex. 28 at 00856 (Ex. 74.2). The "Retirement Board's Assistant General Counsel prepared this ordinance to amend the Municipal Code to make the changes agreed to by the City's Management Team and the four labor organizations and approved by the City Council . . . ." *Id*. at 00857 (Ex. 74.3). This ordinance also implements the benefit increases agreed to in MP II, including the increase in the General Member Retirement Calculation Factor. *Id*. at 00863 (Ex. 74.9). A second Ordinance, adopted on December 3, 2002, provided benefits specifically to Firefighters Local 145, headed by Mr. Saathoff. Ex. 29 (Ex. 107 (Ord. No. 19126)).

Thus, the record shows that MP II was an outgrowth of MP I, developed, sponsored and approved by the same cast of City officials and SDCERS Board members—Herring, Lexin, Webster, Saathoff and Wilkinson—who had facilitated MP I and who each stood to benefit from MP II, as well. As detailed below, the trial testimony also shows that the same City officials (Herring, Lexin, Webster and others) were involved in developing, adopting, enabling and implementing the entire course of alleged unlawful conduct—from MP I and MP II, through the Union MOUs and the implementing legislation, and extending through the *Corbett* settlement—while financially interested in those official actions.

For example, Bruce Herring was a member of the SDCERS Board when it considered MP I. He admitted he was "on the board from January '96 through December 2000," which included "the Manager's Proposal 1 time frame." Ex. 31 at 00953 (Tr. Nov. 15, 2006 a.m. at 51:14-19). Herring admitted that he voted for MP I. *Id.* at 00953 (Ex. 51:20-21). Herring conceded that he attended closed sessions of the SDCERS Board. *Id.* at 00959 (Ex. 57:11-13). Critically, Herring also admitted that he received an increase in benefits "as a result of the benefits approved by the City Council at the same time approximately that MP-1 [was] being considered by the board." *Id.* at 00954 (Ex. 52:1-20).

Jack McGrory identified the following City employees who served on the Board while MP I was considered: Keith Enerson from the Police Department; Ron Saathoff from the Firefighters; Bruce Herring; Terri Webster from the Auditor's Office; Sharon Wilkinson; and Cathy Lexin. Ex. 32 at 01014 (Tr. Nov. 6, 2006 p.m. at 5:7-17). McGrory admitted that Cathy Lexin was "the City's principal labor relations manager" during the end of McGrory's time as City Manager, and that she worked under and reported to Bruce Herring. Ex. 33 at 01104 (Tr. Nov. 6, 2006 a.m. 16:5-14).

Mr. Herring also admitted he was on the SDCERS Board while on the labor negotiating team. Ex. 31 at 00958 (Tr. Nov. 15, 2006 a.m. at 56:18-26). He stated that he was a "Deputy City Manager overseeing" the 1996 meet and confer with the Unions, and that he handled "some of the negotiations directly at the table," and he "had other people who worked with me at the time handle other negotiations directly at the table." *Id.* at 00958-00959 (Ex. 56:27-57:7). According to Jack McGrory, Herring oversaw labor relations. Ex. 33 at 01103 (Tr. Nov. 6, 2006 a.m. at 15:7-10). Herring also admitted he met with the City Council in closed session about labor negotiations. Ex. 31 at 00958 (Tr. Nov. 15, 2006 a.m. at 56:24-26). Herring was sure in 1996 he made it clear to the "labor organizations" that the increased benefits were "dependent upon getting the MP I package through at SDCERS." *Id*. at 00961 (*id.* at 59:2-21).

As for MP II, the City's labor negotiator, Dan Kelley, testified that Cathy Lexin, Terri Webster and Bruce Herring were on the 2002 meet and confer executive management team. Ex. 34 at 01214-01216 (Tr. Nov. 13, 2006 a.m. at 15:24-17:19). Herring admitted he "made a description of the proposal of MP 2 to the board," which consisted of a "detailed proposal of Manager's Proposal 2." Ex. 31 at 0987 (Tr. Nov. 15, 2006 a.m. at 85:4-11). He identified the City employees who worked for the administration who served on the SDCERS Board as including "Cathy Lexin, Mary Vattimo, Terri Webster." *Id*. at 85:26-86:4. Herring also stated that he was on the City Manager's strategy team on labor negotiations in 2002. *Id.* at 00977 (Tr. Nov. 15, 2006 a.m. at 75:4-15). He identified SDCERS Board Member Terri Webster as also serving on the City's 2002 labor negotiating team. *Id*. Additionally, Herring identified other City employees on the SDCERS Board who had a financial interest in MP II as Terri Webster, Cathy Lexin, Sharon Wilkinson, John Torres and Mary Vattimo. *Id*. at 00987-00988 (Tr. Nov. 15, 2006 a.m. at 85:26-86:4).

SDCERS Board Member Ron Saathoff participated in approving MP II in 2002, with a financial interest in a special retirement benefit that allowed him to include his union salary in setting the size of his retirement benefit. Herring testified that there "was an issue brought up by the Firefighter's union on behalf of the president because of the perceived inequity between how their president was treated in the retirement system and other union presidents." *Id.* at 00985 (Tr. Nov. 15, 2006 a.m. 83:17-23). Herring testified that he "heard the conversations at the labor schedule meetings and sat through closed door sessions where" the issue of "whether or not the union salaries" could be taken into account in setting the pension benefits for presidents of the City's unions. *Id.* at 00986 (Tr. November 15, 2006 a.m. 84:3-19). He also testified that he believed that Cathy Lexin participated in those discussions. *Id.* at 00986 (Ex. 84:20-21). Dan Kelley, the City's labor negotiator, testified that with respect to the incumbent union presidents being able to use their union salaries to set their retirement benefits, he looked at "all of the incumbent leave [as] part of the negotiation process." Ex. 35 at 01316-01317 (Tr. Nov. 13, 2006 p.m. at 46:20-47:15).

As the foregoing demonstrates, throughout the MP I and MP II time frame, it was the same cast of City employees and SDCERS Board members, each standing to gain from the benefit increases, that controlled and influenced the pension negotiation and approval process. Many of these same individuals continued to control City labor relations, even through the time of the *Corbett* settlement, discussed *infra*.[6]

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[6] For example, Deputy City Manager Bruce Herring, who was instrumental in both MP I and MP II, who admittedly had a prohibited financial interest in MP I and MP II, Ex. 31 at 00953-00954 (Tr. Nov. 15, 2006 a.m. at 51:14-52:20), and who served on the labor negotiating teams for the City, admitted that in the *Corbett* litigation he represented "the City Manager and the City Council along with the City Attorney's office, and an outside attorney in the negotiations." *Id.* at 00967-00968 (Tr. Nov. 15, 2006 a.m. at 65:27-66:3). Herring stated that he was "one of the lead negotiators on behalf of the City

C. <u>THE UNIONS WERE COMPLICIT IN MP I AND MP II</u>

The evidence demonstrates without question that the Unions were complicit in what was a tri-partite arrangement between certain SDCERS Board members, certain City officials, and the Unions, to exchange benefit increases for underfunding of the system.

The contemporaneous documents show that the Unions knew that the Board was "tampering" with the funding, and they acquiesced in and ultimately supported that result.[7]

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trying to work out a settlement with the other parties." *Id*. at 00968 (Tr. Nov. 15, 2006 a.m. at 66:16-21). In the course of his involvement in the meet and confer negotiations related to the *Corbett* litigation, according to Herring, the matter "morphed into a settlement slash labor negotiations" which "ended up in very long discussions with everybody." *Id*. at 01000-01001 (Tr. Nov. 15, 2006 a.m. at 98:16-21, 98:28-99:9). *See also* Ex. 11 at 00347 (Decision 13:9-11, 16-17) (City Manager Uberaga designated Bruce Herring as the point person in presenting the MP 2 plan to the SDCERS Board").

[7] As MEA representative Ann Smith wrote:

> I cannot state strongly enough how committed MEA's leadership . . . [is] to the following outcomes: (1) a vast improvement in the retirement formula for general members . . . .
>
> I also cannot over-emphasize that the level of employee scepticism [sic] and distrust regarding any ***tampering with funding methods*** related to the retirement system is enormous and will require a yeoman's effort by every person associated with MEA to overcome. ***MEA will not undertake this formidable task unless the gains in benefit levels for the employees MEA represents are clearly respectable*** and credible rather than <u>de minimus</u> [sic].

Ex. 14 at 00631 (Ex. 87.1) (emphasis added). This initial reluctance by the MEA to support MP I in the absence of increased benefits is confirmed by the testimony of Judith

As discussed, the Unions had representatives on the Board itself, and those representatives advocated, voted for and even ***proposed*** aspects of MP I and MP II (resulting in their own benefit increases in exchange for underfunding).

The *quid pro quo* was shared openly with the Union members. *See, e.g.*, Ex. 23 at 00760 (Tr. Nov. 7, 2006 (Testimony of Judith Italiano) at 19:6-21) (explaining that the MEA membership was informed through "Hotsheets" and other communications that "***the City's willingness to include retirement benefit improvements was contingent on the Retirement Board's willingness to adopt the City's proposed new terms and conditions related to contributions and funding levels***") (emphasis added); Ex. 30 at 00900 (Ex. 357) (July 1, 2002 MEA "Hotsheet") (explaining to MEA members that "[t]he availability of these benefit improvements depends on a favorable vote of the retirement board of trustees on the City's request for a payment plan which would lower the current trigger from 82.3% to 75%."). Ms. Italiano specifically testified (by deposition) as to the Union members' knowledge of the exchange of benefits for funding concessions:

> What I remember is that the year before, there had been major concerns from our members about the City wanting just to take funds from the system with no benefit improvements,

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Italiano, who explained that the MEA originally objected to the City Manager's suggestion that the City pay less than its actuarially required contribution "because there was nothing in there for the employees. [The City was] not going to pay their part and there was nothing there to be gained for the people that MEA represents." Ex. 23 at 00763 (Tr. Nov. 7, 2006 p.m. at 26:17-21) (Testimony of Judith Italiano, former President of the MEA). This changed when benefits were added to the mix. *See* Ex. 36 at 01362 (Italiano Depo. at 314:8-16) (Ex. 2205, at 12, clip 5) (MEA's Ann Smith "proposed that we support the City's rate stabilization plan and ramp-up"). *See also* n.4, *supra*.

> and this time around, we made sure that team members spoke with everyone that they could in their workplace and gave them every information they had from the table and did discuss it with people to where they were more comfortable . . . . I know that we had to assure them that we had looked at the information before us.[8] We were comfortable with it, and they were very interested in getting their new benefit.

Ex. 36 at 01361 (Italiano Depo. at 306:4-20 (Ex. 2205, page 11, clip 1)). *See also id.* at 01362 (*id.* at 303:18-22, at 12, clip 7) ("We discussed it in extreme with everyone who voted").

Ms. Italiano frankly admitted the MEA's support for the benefits-for-funding trade off:

> Q. But you were agreeing to allow [the funding for the new benefits] to be postponed. In other words, you were letting the City off the hook for purposes of having to pay for the benefits that the actuary-determined rate was not going to be paid, right?
>
> A. We agreed to allow the City to ramp up their payments over a period of time in return for an improvement in benefits.
>
> Q. Right. So that means you were going to defer where the City was going to get the money later?
>
> A. That's correct. That was their plan.
>
> Q. Why did you do that?
>
> A. It was their proposal, and it improved the benefits for our members.
>
> Q. No. But I'm asking you, though, because you agreed to it, right?

8 *Compare supra* n.5.

> A. My negotiating team agreed to it, and I signed off on it, yes.

Ex. 36 at 01363 (Tr. Nov. 14, 2006 (Italiano Deposition Excerpt at 222:14-223:7, Ex. 2205, at 4, clip 3)); *see also id.* at 01364 (*id.* at 223:17-23, at 5, clip 8) ("Q. Why did you agree to postponing the contributions? A. Because we wanted the benefits. Q. But—I understand that. But why did you agree to postponing the contributions? A. Because that was the way we were going to get the benefits").

The trial evidence also shows that the Unions were on notice that SDCERS Board members were financially interested in MP I and MP II. For example, Ms. Italiano testified that she knew that SDCERS Board members "that worked for the City were going to get every increase that was made for anyone." *Id.* at 01364 (Tr. Nov. 14, 2006 (Italiano Deposition Excerpt at 224:2-4, Ex. 2205, at 5, clip 8)). *See also id.* at 01365 (*id.* at 224:19-24, at 6, clip 8) ("Q. Okay. Now, but you understood that they did have a financial interest in that decision to adopt or not adopt the City's proposed rate stabilization plan, right? A. I knew that they were going to get an improved benefit, yes"). Ms. Italiano also understood that underfunding "***doesn't help the system***." *Id.* at 01365 (*id.* at 226:19, at 6, clip 8) (emphasis added).

The trial evidence also confirms the Unions' direct participation contemporaneous with the adoption of the agreements. Specifically, as to MP I, on June 11, 1996, the SDCERS Board's Special Workshop minutes confirm that the "plan" was the subject of discussions between the City Manager's office ***and the Unions***, as well as the SDCERS Board:

> [Mr. McGrory] indicated that the Manager's office had been ***discussing all of the aspects of their proposal with the employee groups and seeking their concurrence with the plan.***

Ex. 13 at 0454 (Ex. 276.67). *See also* Ex. 32 at 01019 (Tr. Nov. 6, 2006 p.m. at 16:19-24) (Testimony of Jack McGrory) (stating that the discussions regarding the retirement system issues and the extension of the current MOUs were "all one integrated discussion"). Mr. McGrory observed:

> that he believes that these two bodies [the Manager's Office and the Board], ***along with the employee organizations***, have developed an acceptable plan that will solve the City's short and long term problems with the System . . . .

Ex. 13 at 00465 (Ex. 276.78) (emphasis added). The Board also heard testimony from Union representatives, urging the Board to approve this proposal "as a means to allow the general member's benefit levels to be increased . . . ." *Id.* at 00534 (Ex. 276.147). Confirming their participation, the four City Union presidents signed agreements in June 1996 that tied increases in benefits to the SDCERS Board agreeing to allow the City to pay less than the actuarial rate to the City's pension fund. Ex. 15 at 00637, 00645, 00653, 00660 (Ex. 155.5, 155.13, 155.21, and 155.28).

On July 2, 1996, the City Council adopted Resolution No. 287582, adopting MP I. *Id*. at 00633 (Ex. 155.1). That Resolution reflects that the Unions agreed to the proposed benefit increases "subject to the occurrence of various contingencies contained within the proposal." *Id*. The resolution therefore approves the benefit increases "contingent on an affirmative vote of the participants." *Id*. at 00634 (Ex. 155.2). ***Each of the Management Proposals to the Unions was conditioned upon the Union's acceptance of the***

Manager's Proposal to SDCERS. *See Id*. at 00635, 00644, 00652, 00660 (Ex. 155.3, 155.12, 155.20, and 155.28). MEA President Judith Italiano testified that all of the Unions had to approve MP I. Ex. 23 at 00775 (Tr. Nov. 7, 2006 p.m. at 50:5-20).

As for MP II, the Deputy City Manager, Bruce Herring, presented the modified proposal, again in the context of "labor negotiations":

> [H]is proposal is ***in the context of some labor negotiations*** that were recently completed with most of the City's employee labor representatives. What [Herring] is presenting today are ***the implications of these negotiations as they relate to the System and its funding trigger. Although they are separate issues, they are tied into the tentative labor agreement***s.

Ex. 13 at 00566 (Ex. 276.179) (emphasis added). Similarly,

> Mr. Grissom reported that these issues evolved out of ***the meet and confer process*** [between the City and the unions], ***in which a number of benefit enhancements were agreed upon, but made contingent upon the Board's approval of the Manager's funding proposal*** . . . . ***What the City is asking the Board to do is approve*** . . . ***a funding mechanism that would allow these benefit enhancements to be conferred***.

Id. at 00567 (Ex. 276.180) (emphasis added).

Indeed, the record repeatedly reflects that MP II arose out of "labor negotiations":

> The City, ***through labor negotiations***, agreed that the 2.50% at age 55 [increase] is an appropriate benefit to bestow. The City, however, was not willing to grant this benefit, given the cost, if at the same time, it might be facing a jump in retirement contribution rates to full actuarial rate (+$25 million) as a result of the "trigger." Consequently, the City agreed ***contingent*** upon the resolution in this proposal.

Ex. 20 at 00715 (Ex. 1350) (some emphasis in original). On July 11, 2002, when modified MP II came before the SDCERS Board for approval, the discussion again confirmed that MP II was the product of union negotiations:

> ***He [Mr. Grissom] explained that during this year's meet and confer process, the City and Labor Organizations agreed to some benefit enhancements which were subject to the Board's approval of a modification of the (1996-97) Manager's Proposal.***

Ex. 13 at 00590 (Ex. 276.203) (emphasis added).

The trial evidence includes May 2002 letters and a memorandum memorializing offers made directly to the City's four unions that directly tied increased benefits to reduced contributions. These documents each contained, with slight variations, the following message to union leaders:

> Substantial benefit improvements granted by the City since the adoption of the "City Manager's Retirement Proposal" dated July 23, 1996 [MP I] have created additional unfunded liability to SDCERS that was not anticipated when the City agreed to the "trigger" provisions. ***Significant improvements in benefits are contained in this three-year proposal***. Consequently, the "trigger" provisions must be adjusted as a condition of the City's three-year proposal. Therefore, ***this three-year proposal is contingent upon, and subject to, approval by the SDCERS Board of Trustees of an adjustment to the "trigger" provisions contained in the Manager's Proposal [I]*** . . . .

See Ex. 19 at 00696, 00700 (Ex. 272.2, 272.6) (City of San Diego Proposal to the Municipal Employees Association, May 13, 2002) (emphasis added). *See also* Ex. 39 at 01472 (Ex. 311.2) (Proposal to AFSCME Local 127, dated May 13, 2002) (same); Ex. 40 at 01485 (Ex. 274.3) (Proposal to Firefighters Local 145, dated May 13, 2002) ("this three year [benefits] proposal is contingent upon, and subject to, approval by the SDCERS Board of Trustees of an adjustment to the 'trigger' provisions contained in [MP I]"); Ex. 41 at 01492 (Ex. 282 at 2) (Proposal to Police Officers' Association, dated May 24, 2002) (same); Ex. 30 at 00900 (Ex. 357) (MEA Hotsheet) ("UPDATE: Members Ratify Contract Contingent Upon Retirement Board Decision . . . . The availability of these benefit improvements depends on a favorable vote of the Retirement Board of Trustees on the City's request for a payment plan, which would lower the current 'trigger' from 82.3% to 75%. The Retirement Board of Trustees will meet July 11th . . . Please attend this meeting – we need your support"); Ex. 34 at 01228 (Tr. Nov. 13, 2006 at 29:5-9) (Testimony of Dan Kelley).

Ann Smith, representing MEA, wholeheartedly supported MP II before the Board, saying that it "is an important part of MEA's analysis to seek benefit improvements which includes doing its own analysis, to retain its own advisors with regard to the City's budget," to protect the represented employees. Ex. 13 at 00610 (Ex. 276.223) ("***Having reviewed the Manager's proposal, MEA has confidence in the integrity of what is being presented. If not, they wouldn't have supported it***.") (emphasis added). Ed Lehman spoke on behalf of Local 127, and he supported the proposal and "encouraged the Board to act on this proposal today." Judith Italiano likewise supported the measure and urged

MEA's membership to support the proposal. Ex. 42 at 01493 (Ex. 358) ("Hotsheet" urging MEA membership to vote to approve MP II).[9]

After fiduciary counsel, Mr. Blum, stated his opinion of the June 18, 2002 proposal, as to whether counsel "thinks the Board would be sued if the proposal were approved," *id.* at 00619 (Ex. 276.232), that "yes, there is a material risk that the court could find that the Board didn't fully exercise its fiduciary responsibilities in approv[ing] this," *id,* Board Member (and Union President and City employee) Ron Saathoff ***enabled passage of MP II,*** bringing a substitute motion in lieu of the June 18 Manager's Proposal. *Id.* at 00621 (Ex. 276.234).

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[9] Judith Italiano, the former MEA President, has confirmed that the deal was benefits for funding and that the deal was contingent on the SDCERS Board's approval. *See* Ex. 23 at 00759 (Tr. Nov. 7, 2006 p.m.) (Testimony of Judith Italiano) at 17:20-18:3 ("Q. You had full knowledge and notice that the benefits that would have been negotiated in 2002 were conditioned upon SDCERS agreeing to the terms [of MP II]? . . . A. I knew that there were requests of the City Manager to the Retirement Board that had to be taken care of before we could get our bargained agreement, yes."); *see also id.* at 00785-00786 (*Id.* at 70:17-71:7) (Q: "Was it your understanding that the additional increase to 2.5 was conditioned upon M.E.A. going along with the changing of the trigger from 82.3 percent to 75 percent? A. The City asked us to support their request to the Retirement Board, as part of giving us those benefits, yes. . . . Q. You agreed to that, the proposal? A. We agreed to support to the Retirement Board what the manager was asking, yes."); *see also id.* at 00760 (*id.* at 19:6-21) (explaining that the MEA membership was informed through "Hotsheets" and other communications that "the City's willingness to include the retirement benefit improvements was contingent on the Retirement Board's willingness to adopt the City's proposed new terms and conditions related to contributions and funding levels. . ."); Ex. 30 at 00900 (Ex. 357) (July 1, 2002 MEA "Hotsheet") (explaining to MEA members that "[t]he availability of these benefit improvements depends on a favorable vote of the retirement board of trustees on the City's request for a payment plan, which would lower the current 'trigger' from 82.3% to 75%.").

The trial evidence reflects that the Saathoff motion was a pre-planned maneuver. *See* Ex. 21 at 00747 (Ex. 277 at 2) (Lexin Memorandum to City Council dated July 8, 2002) ("Based on our conversations with the Retirement Administrator, we anticipate a motion from a Board member which would further modify the proposal before the Board, by eliminating the request to lower the funded ratio floor, and including the five year phase—in if the trigger (82.3 % funded ratio) is effectuated"). *See also* Ex. 22 at 00748 (Ex. 373) (closed session minutes approving modification if necessary).

The MEA celebrated the ultimate approval by the Board, which "took care of the 'contingency' part of our contract regarding retirement benefits. . ." Ex. 43 at 01494 (Ex. 382) (MEA e-mail dated July 11, 2002); *see also* Ex. 44 at 01495 (Ex. 331) (July 12, 2002 MEA "Hotsheet") ("contingencies of our ratified agreement [have] been met" which will "greatly enhance [members] City benefits").

D. THE EFFECTS OF MP I AND MP II HAVE BEEN DEVASTATING FOR THE CITY AND THE SECURITY OF THE CITY'S EMPLOYEES AND PENSION BENEFICIARIES

Under MP I and MP II, new benefit claims on the pension plan funds were established without the corresponding funding, to the detriment of the entire system. The City's actuarial expert, Joseph Esuchanko, testified that under MP I and MP II, SDCERS's "unfunded actuarial accrued liability had grown from $46.8 million dollars prior to Manager's Proposal I, to $1.157 billion dollars. It further grew to a deficit of 1.394 billion at June 30, 2005." Ex. 37 at 01391 (Tr. Nov. 14, 2006 p.m. at 29:19-27).

The funding level of the pension plan dropped under MP I and MP II from 97.1% to 67.2%. *Id.* at 30:3-8.

Esuchanko testified that post-MP I and MP II, SDCERS has about $1.4 billion more in liabilities than it has in assets:

> Q. Okay. So what you were able to determine is that the present value of assets is about 3 billion, and the present value of liability was about 1.4 billion?
>
> A. 4.4 billion.
>
> Q. I am sorry, yes, 4.4 billion, so that the difference was about 1.4 billion?
>
> A. Correct.
>
> Q. That there is 1.4 billion dollars more in liabilities than in assets?
>
> A. Correct.

Ex. 35 at 01341 (Tr. Nov. 13, 2006 p.m. at 96:7-16). Actuary Esuchanko described the impact of the growing level of distributions against the falling funding of the City's pension plan as a "ruin calculation." Ex. 37 at 01404 (Tr. Nov. 14, 2006 p.m. at 56:1-12).

As this uncontroverted evidence shows, the City's pension plan has been put "at risk" by MP I and MP II. A private pension plan is considered to be "at risk" under federal law if it is less than 70% funded. *See* Pension Protection Act of 2006, § 303(i)(4)(A)(ii), 26 U.S.C. 401. The funding level of the SDCERS plan has fallen below the "at risk" threshold, and a primary cause of this precipitous drop in funding level is the impact of MP I and MP II, which unquestionably increased benefits while also reducing funding.

The Five Year Financial Outlook for the City of San Diego confirms the massive deficits the City faces: Even with highly favorable assumptions incorporated, the Plan projects an approximately $800 million deficit over the next five years. Ex. 46 at 01644-01645 (City of San Diego Five-Year Financial Outlook, Fiscal Years 2008-2012, at Att. 3, Att. 4). The payment of the pension benefits at issue here comprises a substantial portion of that deficit. *Id.* at 01627-01629 (Five-Year Financial Outlook, at 19-21).

IV.

ARGUMENT

In its Phase I Decision, the trial court applied an erroneous mix of procedural and substantive principles of justiciability and *res judicata* to find that events post-dating MP I and MP II could somehow validate the conflict of interest and debt liability limit law violations that unquestionably occurred. Therein lies the unifying error in the court's Decision: These principles simply are not applicable because the City's primary right to be free of conflicts of interest and debt limit law violations as to MP I and MP II has ***never been litigated in any case***, and the intervening actions and events ***could not and did not ratify the earlier misconduct***. The only cure for the violations of law which occurred is that proposed by the City—and rejected by the court—voiding the tainted actions and remanding for new proceedings free from the invalidating conflicts.

A. <u>**UNDER GOVERNMENT CODE SECTIONS 1090 AND 1092, A GOVERNMENT ACTION TAKEN WITH A PERSONAL FINANCIAL INTEREST IS VOID EVEN AS TO "INNOCENT" THIRD PARTIES**</u>

Government Code Sections 1090 and 1092 strictly prohibit precisely the actions described above—governmental actions taken by officials who have a personal financial interest in the decision. Section 1090 provides that:

> [m]embers of the Legislature, state, county, district, judicial district and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members.

Cal. Gov't Code § 1090.

Section 1090 requires that "every public officer be guided solely by the public interest, rather than by personal interest, when dealing with contracts in an official capacity." *Thomson v. Call*, 38 Cal. 3d 633, 650 (1985). It is aimed at eliminating temptation, avoiding the appearance of impropriety and assuring the government of the officer's undivided and uncompromised allegiance. *Finnegan v. Schrader,* 91 Cal. App. 4th 572, 579-80 (2001). Government "officers and employees are expected to exercise absolute loyalty and undivided allegiance to the best interests of the governmental body or agency of which they are officers or employees, and upon the basis that the object of such a statute is to remove or limit the possibility of any personal influence, either directly or indirectly which may bear on an officer's or employee's decision." *Millbrae Ass'n for Residential Survival v. City of Millbrae*, 262 Cal. App. 2d 222, 237 (1968).

If a public official is pulled in one direction by his financial interest and in another direction by his official duties, his judgment cannot and should not be trusted, even if he attempts impartiality. *Carson Redevelopment Agency v. Padilla*, 140 Cal. App. 4th 1323, 1330 (2006). Properly understood, Section 1090 stands as a prophylactic against the temptations that might corrupt or influence public officials. *Id.*

In the context of this case, the public was entitled to have their governmental officials consider the proposed rate stabilization (underfunding) plans in MP I and MP II without those officials receiving more pension benefits if they were able to secure approval. The question to the SDCERS Board simply should have been whether to allow the City to pay less than the actuary said was needed, without the corrupting corresponding consideration of personal financial gain. Rather than divorcing their self-interest from their actions, however, City officials who stood to gain pushed through MP I and MP II, hoping to increase their personal pension benefits. The illegality was compounded, because not only were government officials voting their own benefit increases, but they were enabling and influencing others to adopt those benefit increases by permitting the *quid pro quo* of underfunding, and they were doing so in violation of their preeminent fiduciary duties as trustees for the pension system.

"The case law supports strict enforcement of conflict-of-interest statutes." *Thomson v. Call*, 38 Cal. 3d at 650. *See also Carson Redevelopment Agency v. Padilla*, 140 Cal. App. 4th at 1333 ("The sweep of section 1090 is broad; within its reach comes any interest that might deter a public official from the most righteous and noble path of civil service possible"); *Thorpe v. Long Beach Cmty. Coll. Dist.*, 83 Cal. App. 4th 655, 663 (2000) (statutes prohibiting conflicts of interest are "'strictly enforced'").

Under the "strict" prohibitions of Section 1090, even reliance on advice of counsel is not a defense. As the court wrote in *Thomson v. Call*,

> The trial court's remedy is . . . consistent with a long, clearly established line of cases. Admittedly, the resulting forfeiture seems harsh under the facts of this case. Call was found not to have committed fraud, actual or constructive, or to have conspired to violate section 1090. Indeed, ***he did seek and obtain advice from the city attorney on certain occasions, and he did follow the specific advice he received***. No evidence in the record supports an inference that Call actually initiated the entire transaction, and there is conflicting evidence as to the difference between the fair market value of the parcel and the amount IGC actually paid for it . . . .
>
> The instant statutes are concerned with ***any*** interest . . . which would prevent the officials from exercising absolute loyalty and undivided allegiance to the best interests of the city.

38 Cal. 3d at 647-48 (citations omitted; some emphasis added). *See also Chapman v. Super. Ct.*, 130 Cal. App. 4th 261, 274 (2005) ("reliance on legal counsel's advice is not a defense to a section 1090 violation").

Consistent with this strict enforcement, the Government Code expressly provides that every contract made in violation of Section 1090 is ***void***. Cal. Gov't Code § 1092; *see also Marin Healthcare Dist. v. Sutter Health*, 103 Cal. App. 4th 861, 877 (2002) (a contract in which a public officer is interested is void, not merely voidable); *Stigall v. City of Taft*, 58 Cal. 2d 565, 571 (1962). As a leading treatise on municipal law expresses the concepts:

> The public is entitled to have its representatives perform their duties free from any personal or pecuniary interest that might affect their judgment. Public policy forbids the sustaining of municipal action founded upon a vote of a council member . . . in any matter before it which directly or immediately affects him or her individually . . . . A finding of self-interest sufficient to set aside municipal action need not be based upon actual proof of dishonesty, but may be warranted whenever a public official, by reason of personal interest in a matter, is placed in a situation of temptation to serve his or her own purposes, to the prejudice of those for whom the law authorizes the official to act . . . . ***[A]n individual member ordinarily cannot vote on a matter in which that member . . . is interested. If the member does, the action taken by the body of which he or she is a member is invalidated . . . [and] such ordinance or bylaw is void, irrespective of how beneficial the ordinance may be***.

4 Eugene McQuillin, The Law of Municipal Corporations, § 13.35 at 898-901 (3d ed. 2002) (emphasis added) (citing *Clark v. City of Hermosa Beach*, 48 Cal. App. 4th 1152, 1171-72 (1996)).

Thus, under Section 1092, if the Board members' and City officials' creation, approval and implementation of the MP I and MP II agreements and legislation—which resulted in increasing their own benefits, while underfunding the system they were duty-bound to protect—violated Section 1090 and state conflict of interest law, the resulting agreements are not merely voidable, but void *ab initio*, and they must be set aside. *See Finnegan,* 91 Cal. App. 4th at 583-84 (invalidating contract and citing Section 1092 for proposition that contracts made in violation of Section 1090 are void); *Stigall,* 58 Cal. 2d at 571 (invalidating pursuant to Section 1092 a contract between the city and a plumbing company that was owned in part by a city councilman); *Millbrae Ass'n for Residential Survival*, 262 Cal. App. 2d at 236 (explaining that "[a] contract or transaction entered into in violation of [Section 1090] is invalid," and citing Section 1092 in reversing and remanding a decision holding that a contract was valid despite violation of Section 1090); *see also Thomson*, 38 Cal. 3d at 646 & n.15 (collecting cases and stating that "California courts have generally held that a contract in which a public officer is interested is void, not merely voidable."); *In re Barlow*, 67 Op. Atty. Gen. Cal. 369 (1984), 1984 WL 162079, *5 ("Contracts made in violation of section 1090, though described as voidable in section 1092, are in fact void.").

If an official is a member of a board that actually executes or approves the contract, he or she is conclusively presumed to be involved in the making of his or her agency's contract. *Thomson*, 38 Cal. 3d at 645, 649. The mere presence of one board member with a financial interest in a transaction is sufficient to invalidate that transaction, even if the member has not voted on the matter or participated in discussions leading up to the vote. *Finnegan*, 91 Cal. App. 4th at 581-82. The prohibitions of Section 1090 reach "preliminary discussions, negotiations, compromises, reasoning, planning, drawing of plans and specifications and solicitation for bids." *Millbrae Ass'n for Residential Survival*, 262 Cal. App. 2d at 237. *See also Chapman v. Super. Ct.*, 130 Cal. App. 4th 261, 274 (2005) (the "term contract is interpreted broadly under section 1090 and includes 'the negotiations, discussions, reasoning, planning, and give and take [that] go beforehand in the making of a decision'").

Section 1090 case law emphasizes that all related transactions or events should be considered. "[I]n considering conflicts of interest [courts] cannot focus upon an isolated 'contract' and ignore the transaction as a whole." *People v. Honig*, 48 Cal. App. 4th 289, 320 (1996); *see also People v. Gnass*, 101 Cal. App. 4th 1271, 1294 (2002) (reviewing California law and stating that courts "look[] past the individual contracts in question and consider[] the relationships between all the parties connected with them, either directly or indirectly, to determine if a conflict of interest existed."); *Campagna v. City of Sanger*, 42 Cal. App. 4th 533, 541 (1996) (related agreements must be viewed with reference to one another in applying Section 1090).

Thus, courts should not be "***concerned with the technical terms and rules applicable to the making of contracts, but instead [with] rules governing the conduct of government officials***." *See Honig*, 48 Cal. App. 4th at 314-15 (emphasis added); *see also Stigall*, 58 Cal. 2d at 569; *accord Hobbs, Wall & Co. v. Moran*, 109 Cal. App. 316, 320 (1930) (when a public official is financially interested in a contract, the transaction is void and "in its effort to uphold the transaction, a court will not resort to fine distinctions in order to determine just what facts will constitute an 'indirect interest' on the part of the officer."). It is therefore critical to ascertain the true nature of officials' relationships, no matter how complicated a transaction may be. *See Honig*, 48 Cal. App. 4th at 315 (citing *People v. Watson*, 15 Cal. App. 3d 28, 37 (1971)).

Similarly, Section 1092 requires courts to void transactions involving both direct and indirect interests. *See, e.g., Carson Redevelopment Agency v. Padilla*, 140 Cal. App. 4th at 1333-34; *Terry v. Bender*, 143 Cal. App. 2d 198, 206-07 (1956) ("The public officer's interest need not be a direct one, since the purpose of the statutes is also to remove all indirect influence of an interested officer as well as to discourage deliberate dishonesty).

Indeed, the California Supreme Court has made clear that Section 1090 will sweep in all aspects of the tainted official action, both contractual and legislative. *See Thomson v. Call*, 38 Cal. 3d at 644 (finding single multi-party agreement based upon "IGC's letters proposing the $600,000 plan, ***the relevant resolutions adopted by the city council,*** the acceptance of the deeds and ratification of the purchases made by IGC, the use and building permits, and the real estate purchase contracts") (emphasis added).

The evidence and the trial court's findings in this case leave no doubt that MP I and MP II were a package deal (benefit increases for underfunding concessions), and that the Board members may not cabin their financial interest in and approval of the benefits from the permission to underfund the system. As the trial court found:

> [T]he negotiations included a wide variety of issues that were all ***interrelated***. All involved in the negotiations testified concerning the interrelationship of the factors . . . . The Managers Proposal presented retirement benefit enhancements that the City was in the process of negotiating with its workers ***together with*** a proposal to reduce the City's contribution to the pension system to a level below the actuarial required rate. The union representatives involved in the MMBA negotiations were kept appraised [sic] of Mr. McGrory's effort at SDCERS. Concerns were raised at SDCERS concerning the propriety of allowing funding at the proposed reduced rate.

Ex. 11 at 00342 (Decision at 8:12-13; *id*. at 8:24-9:7) (citations omitted) (emphasis added). *See also* Ex. 11 at 00347 (Decision at 13:18-24) ("Concerns regarding the propriety of the proposal were raised by a number of board members including Mr. Vortman and Ms. Shipione. The concerns covered a wide variety of issues including, but not limited to, whether the board members could approve such a proposal while fulfilling fiduciary duties, whether the pension would be adequately funded and the potential for indemnification of board members by the City from potential litigation exposure.") (citations omitted).

Thus, in a matter in which they had a direct financial interest—increasing their own individual (and in some cases special) benefits—SDCERS Board members not only approved the benefit increases, but further allowed the funding for the pension system they were duty-bound to protect to be reduced to influence City officials to approve the benefit increases.

There are numerous cases invalidating contracts involving interested government officials in circumstances akin to those alleged here. *See, e.g., City Council v. McKinley*, 80 Cal. App. 3d 204, 213 (1978) (affirming refusal to enforce contract as invalid under Section 1090; contract between landscape firm and City Park and Recreation Board invalid where board member was president and stockholder of landscape firm: "The law of this state is that public officers [which include board members] shall not have a personal interest in any contract made in their official capacity . . . . [T]he object . . . is to remove or limit the possibility of any personal influence either directly or indirectly which might bear on an official's decision as well as to void contracts which are actually obtained through fraud or dishonest conduct. Statutes prohibiting such 'conflicts of interest' by a public officer are strictly enforced. These propositions are supported by a plethora of authority most notably Government Code sections 1090-1092 . . . .") (citation omitted).[10]

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[10] *See also Imperial Beach v. Bailey*, 103 Cal. App. 3d 191 (1980); *Finnegan*, 91 Cal. App. 4th at 584 (affirming finding that Section 1090 voided the appointment by a

When Section 1090 is transgressed, the public entity involved is entitled to recover any compensation that it paid under the unlawful contract without restoring any of the benefits it received: The contract is against the express prohibition of the law, and the courts will not entertain any rights growing out of such a contract, or permit a recovery upon quantum meruit or quantum valebat. *Carson Redevelopment Agency v. Padilla*, 140 Cal. App. 4th at 1331. *Carson* makes clear that conflicts of interest invalidate the resulting action, even when the result harms innocent third parties. The court held that disgorgement of amounts paid by the city to owners of a senior housing complex under a contract tainted by conflict of interest was an automatic remedy; even though the owners were victims themselves, their interest must yield to the "greater interest" of the public in avoiding corruption and its effects on the public fisc. *Id.* at 1336-37.

As the court wrote in *Carson*:

> If any interest compromises a public official's fidelity such that he may be influenced by personal considerations rather than the public good, then there must be a mechanism to ameliorate the concomitant injury to society. Section 1092 is that mechanism. It would lose much of its sting if it were not permissible to unravel the machinations of criminal minds and trace their paths of deceit to pinpoint indirect financial interests that might influence public officials.

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board of one of its own members as district manager of a sanitary district, even though he did not personally vote); *Campagna v. City of Sanger*, 42 Cal. App. 4th 533, 538-39, 541-42 (1996); *Downey Cares v. Downey Cmty. Dev. Comm'n*, 196 Cal. App. 3d 983, 988-91 (1987) (invalidating a city action (an ordinance) because it was reasonably foreseeable that the ordinance could have a material effect on a council member's financial interest; "[t]he test is whether it was reasonably foreseeable that the adoption of the plan would have a material financial effect on [the member's] property and business . . . ."); *Witt v. Morrow*, 70 Cal. App. 3d 817, 822 (1977) (councilman acting as member of redevelopment agency disqualified from participating in decisions on development plan where it could have an effect on nonprofit corporation of which official was officer).

Id. at 1334 (citation omitted). The court elaborated:

> The rule of forfeiture is not an outmoded remedy blind to equity. It is, rather, a remedy that is utilitarian in its design; it recognizes what is equitable for the community and necessarily subordinates the individual in a given case. Ultimately, this policy serves all individuals because they comprise our communities and need every guarantee the law can provide that they will be free from the tyranny of corrupt politicians and the burden of contracts tainted by conflicts of interest.

Id.

Thus, as *Carson* notes, when "section 1090 is transgressed 'the public entity involved is entitled to recover any compensation that it . . . paid under the contract without restoring any of the benefits it . . . received.'" *Id.* at 1331 (quoting *Finnegan*, 91 Cal. App. 4th at 583). The disgorgement of benefits received under a void contract is "automatic":

> *Thomson* gave its imprimatur to a long line of cases applying that remedy, and it approved that remedy against Call. *Thomson* considered a flexible rule, but then decided against it for policy reasons after considering the unacceptable ramifications of such a rule. More recently, *Finnegan* held that a public entity is entitled to recover any compensation it paid under a tainted contract without restoring any of the benefits it received. By logical import, *Finnegan* interpreted *Thomson* as a binding precedent holding that the disgorgement remedy is automatic. For policy reasons, we follow the lead of *Finnegan*. We do so for two reasons. Based on stare decisis, we pay deference to the long history of consistent appellate case law recognized in *Thomson*. Also, as a policy matter, it is the most effective way to give section 1090 all the teeth that it needs.

Id. at 1334-36 (citations omitted).

Likewise, in a United States Supreme Court case strikingly similar to this one, trustees of union health and retirement funds sued a coal producer (Kaiser) for contributions due under a collective bargaining agreement. *Kaiser Steel Corp. v. Mullins*, 455 U.S. 72, 74-76 (1982). Kaiser claimed that it did not owe the contributions because the collective bargaining agreement giving rise to them was illegal. *Id.* at 76. The Supreme Court agreed that Kaiser was entitled to claim the contract was illegal, and explained that ordering Kaiser to make the contributions would be tantamount to enforcing an illegal agreement, something the Court refused to do. *Id.* at 77-82. Significantly, the Court refused to enforce the illegal agreement ***even when doing so reduced the health and retirement funds of the union members***. *Id.* at 83 & n.8 (explaining that "***pension fund trustees have no special status which exempts them from the general rule that courts do not enforce illegal contracts***"); *see also Carpenters Amended & Restated Health Benefit Fund v. Cope & Smith*, 544 F. Supp. 442, 450 (N.D. Tex. 1982) (court refused to require employer to contribute to pension funds when the contributions inherently were linked to an illegal agreement).

Simply put, courts do not enforce illegal contracts, no matter who the beneficiaries may be. *See Miller v. McKinnon*, 20 Cal. 2d 83, 89 (1942) (person who has supplied labor and materials in performance of illegal contract has no right to recover thereunder); *Amelco Electric v. City of Thousand Oaks,* 27 Cal. 4th 228, 234 (2002) (same); *see also Finnegan*, 91 Cal. App. 4th at 584 ("Various provisions of the Labor Code do evince a strong public policy of ensuring employees are paid fully and promptly for their efforts. We do not believe that these provisions were intended to ratify illegal employment contracts or to immunize a public official from liability for a conflict of interest. The disgorgement remedy adopted by the trial court was appropriate.") (citation omitted); *Campagna*, 42 Cal. App. 4th at 542 (city attorney who negotiated referral agreement in which he stood to benefit forfeited right to funds); *Millbrae Ass'n for Residential Survival*, 262 Cal. App. 2d at 237-38 (fact that public contract had been substantially performed would not preclude contracts from being invalid due to conflict of interest).

Notably, although the trial court misconstrued the effect of subsequent settlements and negotiations, wrongly believing they somehow ratified the illegal benefits, discussed *infra*, the trial court, too, recognized that benefits paid out in violation of Section 1090 are subject to disgorgement. Ex. 11 at 00355 (Decision at 21:13-18) (stating that the disgorgement remedy is available for benefits paid out under MP I).

While Intervenors repeatedly argued that the court cannot take away rights that have "vested" in the beneficiaries as a result of MP I and MP II, that argument ignores the preliminary question of whether the rights have "vested." "The words [vested rights] are generally used as implying interests which it is ***proper*** for the state to recognize and protect, and of which the individual cannot be deprived arbitrarily without injustice." *American States Water Serv. Co. v. Johnson*, 31 Cal. App. 2d 606, 614 (1939). As evidenced from *Thomson* and *Carson*, *supra*, contracts entered into in violation of

Section 1090 are void and not enforceable. Thus, if the benefit contracts were illegally adopted, no pension benefits could vest under them. *Kaiser*, 455 U.S. at 83 & n.8.[11]

As will be seen below, despite the plethora of authority that actions tainted by conflict of interest are void, even against "innocent" beneficiaries—including pension beneficiaries—the trial court's Decision bars the City from setting aside the SDCERS Board's and other governmental officials' conflicted actions on an erroneous legal theory that those void actions can be validated by subsequent settlements reached in cases ***which do not even address the Section 1090 violation.***

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[11] Indeed, courts frequently have set aside beneficiaries' claims to pension benefits when such claims rest on an illegal agreement. *See Romano v. Retirement Bd. of the Employees' Retirement Sys.*, 767 A.2d 35, 38-39 & n.3, 46-47 (R.I. 2001) (pension benefits that arose based on ultra vires actions, and which were in conflict with state law could not be enforced—even when beneficiary allegedly "'committed no evil' when he feathered his retirement nest with over $100,000 in illegal public retirement benefits"); *Strong v. State of Oklahoma ex rel. The Oklahoma Police Pension & Retirement Bd.*, 115 P.3d 889, 894-95 & n.23 (Okla. 2005) (retirement system could not be estopped from denying illegal benefits) (citing numerous cases); *Fraternal Order of Police, Lodge No. 2 v. County of Douglas*, 612 N.W.2d 483, 488 (Neb. 2000) (affirming summary judgment that pension plan benefits reduction was null and void under governing law requiring voter approval); *Plainfield Township Policemen's Ass'n v. Pa. Labor Relations Bd.*, 695 A.2d 984, 985 (Pa. Comm. Ct. 1997) (affirming Labor Relations Board's refusal to enforce pre-existing pension benefits that were illegal under law and should never have been agreed to in collective bargaining agreement). *See also Retirement Bd. of Allegheny County v. Colville*, 852 A.2d 445, 451-52 (Pa. Comm. Ct. 2004) (refusing to remand to enforce illegal retirement benefits); *Borough of Ellwood City v. Ellwood City Police Dep't Wage & Policy Unit*, 805 A.2d 649, 651 (Pa. Comm. Ct. 2002) (refusing to enforce illegal pension benefits); *Bd. of Control of the Employees' Retirement Sys. of Alabama v. Hadden*, 854 So. 2d 1165, 1169 (Ala. Ct. Civ. App. 2002) (employees' retirement system could not be estopped from suspending illegal retirement benefits); *accord City of Wilkes-Barre v. City of Wilkes-Barre Police Benevolent Ass'n*, 814 A.2d 285, 288-89 (Pa. Comm. Ct. 2002) (unlawful retirement benefits unenforceable where statute provides for unenforceability of excessive benefits); *cf. Parella v. Retirement Bd.*, 173 F.3d 46 (1st Cir. 1999) (legislators had neither contract nor property rights to pension benefits that exceeded amount permitted by law).

B. NONE OF THE COURT'S PHASE ONE RULINGS SHOULD BAR THE CRITICAL MERITS DECISIONS

1. THE TRIAL COURT ERRED AS A MATTER OF LAW IN FINDING THAT THE *CORBETT* SETTLEMENT BARS LITIGATION AS TO THE LEGALITY OF THE MP I BENEFITS

The trial court first found that all of the City's claims as to MP I are barred by a settlement reached in the *Corbett* litigation, *Corbett v. City Employees' Retirement System*, San Diego Superior Court Case No. GIC 722449, ***a case which had nothing to do with either MP I or conflict of interest laws.*** *Corbett* instead dealt only with the narrow question of whether City employees were entitled to have certain monies included in the base compensation component of their retirement pay under the Supreme Court decision in *Ventura County Deputy Sheriffs' Association v. Board of Retirement,* 16 Cal. 4th 483 (1997). Ex. 47 at 01646-01652 (*Corbett* Complaint).

The City settled *Corbett* in 2000. Ex. 48 at 01653-01673 (Ex. 930) (*Corbett* judgment). As for City employees who terminated employment on or before July 1, 2000, the settlement agreement provides for an increase in their "retirement benefit payment" of a simple 7% both prospectively and retroactively. As for those actively employed by the City on July 1, 2000, the agreement provided for increases in the Retirement Calculation Factor for Safety Members (from 2.5% to 3.0%) and for General Members (from 2.0% to 2.5%).

Despite the complete absence of any issue in *Corbett* regarding MP I—much less a contention that MP I is void under state or local conflict of interest law—the trial court erroneously wove together a patchwork of *res judicata* and ratification principles, and held that the 2000 *Corbett* judgment bars the City from challenging the legality of MP I.[12]

a. Preclusive Principles Do Not Support a Finding that the City's Conflict of Interest Claim Is Barred by the *Corbett* Judgment

In evaluating the error, it is important to distinguish between claim preclusion (or bar/merger) and issue preclusion (or collateral estoppel). Claim preclusion bars a party or its privy from suing on the ***same cause of action*** in a subsequent case after final judgment in an earlier case. *E.g.*, *Border Business Park, Inc. v. City of San Diego*, 142 Cal. App. 4th 1538, 1563 (2006) ("In its primary aspect the doctrine of res judicata [or 'claim preclusion'] operates as a bar to the maintenance of a second suit between the same parties on the same cause of action.") (quoting *Kelly v. Vons Companies, Inc.*, 67 Cal. App. 4th 1329, 1335 (1998)); *McNulty v. Copp*, 125 Cal. App. 2d 697, 708 (1954) (a judgment in one lawsuit is res judicata only on the same cause of action in a second lawsuit; matters not at issue are not res judicata in subsequent litigation). Because the party had its day in court in the first case as to the entire cause of action (including all matters raised or which could have been raised), it is barred in subsequent cases from asserting not only all issues that were actually litigated, but those that could have been

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[12] *Corbett* pre-dated MP II and, therefore, no party contended that *Corbett* affected MP II.

litigated arising out of that cause of action or primary right. *E.g.*, *Lincoln Property Co., N.C., Inc. v. Travelers Indem. Co.*, 137 Cal. App. 4th 905, 912-13 (2006) ("[N]umerous cases hold that when there is only one primary right an adverse judgment in the first suit is a bar even though the second suit is based on a different theory or seeks a different remedy.") (quoting *Crowley v. Katleman*, 8 Cal. 4th 666, 681-82 (1994)). This is the so-called "should have been raised" bar, which precludes subsequent litigation of foregone claims arising out of the same cause of action or primary right at issue in the first case. *Lincoln Property Co., N.C., Inc. v. Travelers Indem. Co.*, 137 Cal. App. 4th at 913 ("Under this aspect of res judicata the prior final judgment on the merits not only settles issues that were not actually litigated but also every issue that might have been raised and litigated in the first action.") (quoting *Mattson v. City of Costa Mesa*, 106 Cal. App. 3d 441, 446 (1980)).

By comparison, issue preclusion or collateral estoppel deals with a subsequent case involving a ***different cause of action***. *E.g.*, *Bronco Wine Co. v. Frank A. Logoluso Farms*, 214 Cal. App. 3d 699, 708 (1989) ("[Collateral estoppel] applies regardless of whether the issue was brought on the same or on a different cause of action."). When a party to a prior lawsuit is involved in subsequent litigation on a different cause of action, under certain circumstances, that party may assert offensively or defensively that a particular issue has been litigated in an earlier case and therefore cannot be relitigated in the present case. *See Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 332-333 (1979); *Sutton v. Golden Gate Bridge, Highway & Transp. Dist.*, 68 Cal. App. 4th 1149, 1157 (1998). To invoke collateral estoppel, a party must show: (1) identity of issues; (2)

identity of parties; and (3) a final judgment. *Lucido v. Super. Ct.*, 51 Cal. 3d 335, 341 (1990). As to the first element, the same issue must actually and necessarily have been litigated in the prior case to be binding in the second case. *Lucido*, 51 Cal. 3d at 341. Thus, the "should have been raised" concept of bar/merger or claim preclusion has no place in collateral estoppel analysis and only issues actually litigated are subject to estoppel in the subsequent action. 7 B.E. Witkin, California Procedure, Judgment, § 257 (3d ed. 1985) ("[A] former judgment is not a collateral estoppel on *issues which might have been raised but were not*: just as clearly, it is a collateral estoppel on issues which were raised, *even though some factual matters or legal arguments which could have been presented were not*.") (italics in original).

Respectfully, the trial court's *Corbett* analysis misapprehends these basic principles. The court held that the City is "estopped" from litigating conflict of interest and debt limit law violations and challenging the void agreement (MP I) because the City settled and judgment was entered in an earlier case which had ***nothing to do with either MP I or conflict of interest or debt limit law***. Indeed, the trial court's decision makes this point clear:

> On July 16, 1998, the *Corbett* class action lawsuit against the SDCERS board was filed . . . . The City appeared in the case as a real party in interest. The litigation alleged SDCERS miscalculated the "final compensation" of city workers by excluding from the calculation additional items of compensation such as uniform allowances, vacation allotments, overtime and other benefits the court had required Ventura County to include in its calculation of "final compensation" for deputy sheriffs [in] . . . *Ventura County Deputy Sheriff's Assn. v. Board of Retirement of Ventura County Employees Retirement Assn.* (1997) 16 Cal.4th 483.

> ***The Corbett case was based on the exclusion of these Ventura County benefits from "final compensation" calculations at SDCERS <u>and did not involve allegations of violation of Government Code section 1090 or a challenge to benefits enacted in 1997</u>.***

Ex. 11 at 00344 (Decision at 10:1-13) (emphasis added).

Thus, *Corbett* did ***not*** involve the same primary right or cause of action as the City's claim in this case. Hence, ***principles of claim preclusion and "what should have been litigated" have no bearing.*** Likewise, issue preclusion or collateral estoppel (which, as noted, would bind the City only on matters actually and necessarily litigated in the *Corbett* case) is not applicable: As the court's decision confirms, Section 1090 and MP I benefits were ***not*** actually and necessarily litigated in *Corbett.* Hence, as a matter of law, neither claim preclusion nor issue preclusion arising from the *Corbett* judgment could preclude the City from litigating the validity of benefits awarded in exchange for underfunding in MP I in this case.[13]

Despite this seemingly straightforward conclusion that a judgment in an earlier case that did not involve a cause of action for conflict of interest violations (and in which such issues were not litigated) cannot preclude conflict of interest claims raised in a subsequent lawsuit, the court nonetheless found the *Corbett* judgment barred the City

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[13] Whether the trial court correctly decided res judicata is a question of law reviewed *de novo* by this Court. *E.g.*, *Allstate Ins. Co. v. Mel Rapton, Inc.*, 77 Cal. App. 4th 901, 907 (2000); *see also* Ex. 11 at 00350 (Decision at 16:7-8) (deciding effect of *Corbett* as a "matter of law") (capitalization omitted); *id*. at 16:23-24, 18:3-4, 20:3-6 (interpreting *Corbett* judgment language). *See also In re Mission Ins. Co*., 41 Cal. App. 4th 828, 835 (1995) (interpretation of settlement agreement reviewed de novo); *Coast Plaza Doctors Hosp. v. Blue Cross of California,* 83 Cal. App. 4th 677, 684 (2000) (court reviews language of instrument, here an arbitration clause, de novo).

from challenging MP I on those grounds based upon an amalgam of *res judicata* principles. *See* Ex. 11 at 00338 (Decision at 4:2) (judgment is "binding on the City"); *id.* at 4:14-15 (*Corbett* judgment is "binding on all parties to it").

First, in language suggesting claim preclusion, the court found that "any claims based on pre-*Corbett* [MP I] benefits have been ***merged*** in the *Corbett* judgment." Ex. 11 at 00354 (Decision at 20:10) (emphasis added). "The benefits in effect at the time of, and underlying, the *Corbett* judgment, including benefits funded under MP I, cannot now be set aside because doing so would invalidate the *Corbett* judgment." *Id.* at 11:13. The Court does not explain—nor can it—how the claim preclusion concept of bar/merger finds its way into an analysis of a subsequent lawsuit admittedly brought on an entirely ***different cause of action*** than pleaded in *Corbett*.[14]

The court then compounds the error by slipping from claim preclusion (and merger) into issue preclusion and an ***estoppel*** analysis. The court continues:

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[14] The only case cited by the court, *Tomaselli v. Transamerica Ins. Co.*, 25 Cal. App. 4th 1766, 1770 (1994), does not support its analysis. In *Tomaselli*, plaintiffs brought the same claim (breach of contract) twice. *Id.* at 1769-70 ("The current lawsuit seeks recovery based on respondents' failure to pay the ***same claim*** which was the subject of action one."). The Court held that plaintiffs could not recover on their second claim because "[w]hen a party recovers a judgment for breach of contract, entry of the judgment absolves the defendant of any further contractual obligations, and the judgment for damages replaces the defendant's duty to perform the contract." *Id.* at 1770. That holding is irrelevant here. First, it addresses only breach of contract cases and resulting judgments. *Corbett* was not a breach of contract case and thus the settlement of that action did not and could not extinguish any contractual rights, meaning that contractual rights created by MP I survive. Second, *Tomaselli*'s rationale depends upon the ***same breach of contract claim*** being brought twice. *Id.* at 1769. Here, different plaintiffs (the *Corbett* class in action one and the City in action two) bring different claims and neither is a breach of contract claim.

> Accordingly, the City is estopped from pursuing claims which seek to invalidate such [MP I] benefits. Intervenors' special defense based on the Corbett judgment is sustained. Benefits enacted by the Corbett judgment cannot be nullified in this action.

Ex. 11 at 00354. Decision at 21:3-6 (citations omitted) (emphasis added). ***The court does not explain—nor can it—why it eschews the "actually litigated" requirement of collateral estoppel***, or how estoppel applies when admittedly the issue on which the City supposedly is estopped (whether MP I violated conflict of interest laws) was not "actually or necessarily" litigated in the earlier case. *See, e.g.*, *Kaufman & Broad Cmtys., Inc. v. Performance Plastering, Inc.,* 136 Cal. App. 4th 212, 224 (2006) (stating that "to the extent that issues relevant to coverage were not actually litigated in the first lawsuit, the insurance company is not barred from asserting these issues in the second lawsuit under the doctrine of collateral estoppel."); *Le Parc Cmty. Ass'n v. Workers' Comp. Appeals Bd.*, 110 Cal. App. 4th 1161, 1174 (2003) (holding that a worker's compensation claimant was not barred from litigating the issue of who his employer was because that issue was not actually litigated in a prior negligence case).[15]

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[15] To support this application of "estoppel," the court relies on *Sawyer v. City of San Diego*, 138 Cal. App. 2d 652, 662 (1956), and *City of Coronado v. City of San Diego*, 48 Cal. App. 2d 160, 172 (1941). Neither applies. Both *Sawyer* and *City of Coronado* stand for the principle that a party's behavior may estop him from changing his interpretation of a valid contract. *Sawyer*, 138 Cal. App. 2d at 660, 662 (holding that the City was estopped from changing its interpretation of a contract); *City of Coronado*, 48 Cal. App. 2d at 172 (holding that "City is estopped to insist now upon a different *interpretation* of the contract"). But this case involves neither contract interpretation nor a valid contract. Here, the City is not attempting to construe the terms of MP I or MP II differently than it has in the past, but is instead seeking to void MP I and MP II entirely, as the law demands. Further, because *Sawyer* and *City of Coronado* implicated valid contracts, the issue of whether subsequent behavior can ratify a void contract never arose. *Sawyer*, 138

In short, whether claim or issue preclusion is considered, the *Corbett* judgment simply cannot bar or estop the City from litigating the conflict of interest claims regarding MP I in this action. The trial court's conclusion to the contrary is erroneous as a matter of law.

b. Ratification or Estoppel Will Not Cure a Section 1090 Violation and the Court Erred In Relying on Those Theories

The court's discussion also suggests that in addition to a ***judicial*** bar or estoppel arising from the *Corbett* judgment, it may be relying upon a ***contractual*** ratification or estoppel analysis, based on the City's agreement to settle *Corbett* and the various Memoranda of Understanding (MOUs) adopted after MP I. If the court's theory is that the City contractually ratified or validated the prior conflict of interest violations, and therefore is "estopped" to challenge the illegal benefits awarded, the court is seriously mistaken on that ground, as well.[16]

Cal. App. 2d at 660 (holding that the City had the authority to enter into the contract); *City of Coronado*, 48 Cal. App. 2d at 173 ("The contract was valid when entered into and no good reason appears why . . . [it] should be held to be invalid."). The court repeatedly cites *Sawyer* for the proposition that standard principles of contract interpretation apply to contracts in which governmental entities are a party. *See* Ex. 11 at 00352 (Decision at 18:9-12). *Sawyer* is not a Section 1090 case, however, and it does not stand for the proposition that a subsequent contract can validate an earlier Section 1090 violation.

[16] In fact, the trial court expressly recognized that the 1998 MOU process was not a ratification of an earlier contract. Ex. 11 at 00361 (Decision at 39:27).

As the City has demonstrated repeatedly—before trial, at trial, after trial in its Proposed Statement of Decision, and above (at 49-52)—the case law and treatise authority unanimously recognizes that a Section 1090 violation makes the resulting governmental action ***void*** (not merely voidable). And, critically for present purposes, not only is the government action void *ab initio*, but ***it may not be validated by ratification or estoppel***. *See Berka v. Woodward*, 125 Cal. 119, 129 (1899) (the fact that claim was allowed by the council did not give it validity that it did not otherwise possess; contract based on conflict of interest was void); *see also City Lincoln-Mercury Co. v. Lindsey*, 52 Cal. 2d 267, 274 (1959) ("A party to an illegal contract cannot ratify it, cannot be estopped from relying on the illegality, and cannot waive his right to urge that defense"); *Fewell & Dawes v. Pratt*, 17 Cal. 2d 85, 91 (1941) ("An illegal contract cannot be ratified, and no person can be estopped from denying its validity"); *Downey Venture v. LMI Ins. Co.*, 66 Cal. App. 4th 478, 511 (1998) ("An illegal contract is void; it cannot be ratified by any subsequent act, 'and no person can be estopped to deny its validity.' It is clear that estoppel cannot be relied upon to defeat the operation of a policy protecting the public.") (citation omitted); *accord Timney v. Lin*, 106 Cal. App. 4th 1121, 1129 (2003) (an illegal clause in a settlement cannot be immunized or ratified by approval of the settlement); *see generally* 1 B.E. Witkin, Summary of California Law, Contracts § 432 (10th ed. 2006) ("Because an illegal contract is void, it cannot be ratified by any subsequent act, and no person can be estopped to deny its validity").[17]

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[17] *See also* 17A Am. Jur. 2d *Contracts* § 308 (2006) ("A contract that is void as

As also discussed above, at pages 55-59, the presence of third party beneficiaries, even innocent ones, cannot avoid this result. It is hornbook law that "[a] third person for whose benefit an illegal contract is made does not, as a rule, acquire any rights thereby." 17A C.J.S. *Contracts* § 286 (2005). Rather,

> [t]he general rule is that if the express contract is one the municipality had no power to make, i.e., ultra vires in the strict sense of the term, or if the municipality could not make an express contract of the kind sought to be enforced, the municipality cannot be held liable . . . for the value of benefits received. A municipality is not required to compensate for benefits received under a void contract, where to do so would be tantamount to annulling a statute, or doing by indirection that which the municipality is not permitted to do directly. ***These rules are designed to protect the municipal taxpayers*** . . . .

10A Eugene McQuillin, The Law of Municipal Corporations, § 29.111.10 (emphasis added); *see also Miller v. City of Martinez*, 28 Cal. App. 2d 364, 370-72 (1938) (city could recover price of goods received under contract void for conflict of interest without returning goods; because the contract was void as against public policy, "there is no ground for any equitable considerations, presumptions or estoppels"); *accord G.L.*

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against public policy or statute cannot be made valid by ratification"); 10A Eugene McQuillin, The Law of Municipal Corporations § 29.104.30 ("Contracts which a municipal corporation is not permitted legally to enter into are not subject to ratification"; no ratification of contract that is contrary to declared public policy); 64 C.J.S. *Municipal Corporations* § 914 (2005) ("A municipal contract which is void in its inception is not validated by performance but remains a void contract.") Indeed, the municipality may avoid performance even though other party has performed: "Where the municipality fails to comply with a statute, and the purpose of the statute is to protect taxpayers rather than the municipality, equity may not be invoked to enforce an agreement against the municipality. . . . [M]unicipal contracts involving in their execution or enforcement a violation of public policy are void." *Id.* *See also id*. at § 915 (an ultra vires or illegal contract is not susceptible to validation).

Mezzetta, Inc. v. City of American Canyon, 78 Cal. App. 4th 1087, 1094 (2000) (estoppel may not be invoked to enforce a void contract); *Shasta County v. Moody*, 90 Cal. App. 519, 523 (1928) (the "contracts being void under the express provisions of the statute, and also being against public policy, there is no ground for any equitable considerations, presumptions or estoppels").

The court's decision cites no authority permitting the City Council to impliedly ratify (whether through MOUs or case settlements) an earlier action taken with an invalidating conflict of interest.[18] Indeed, the *Corbett* settlement did not even purport to ratify the prior illegal benefits: The *Corbett* settlement neither entailed nor contemplated confirmation of the underlying benefits.[19]

The only way for the prior illegal actions to be "ratified" would be for the court to void the wrongdoing and to remand to the City Council new proceedings free of the invalidating conflict, as discussed, *infra*, at 131-134, thereby ***curing*** the conflict. The MOUs and *Corbett* settlement do not constitute such a cure, which requires disclosure of

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[18] To the contrary, the City Council had a duty to set aside actions taken with a disqualifying conflict of interest. *Schaefer v. Berinstein*, 140 Cal. App. 2d 278, 289-93 (1956) (upon violation of Section 1090, city council had duty to declare resulting action void).

[19] Ex. 45 at 01573 (Tr. Nov. 8, 2006 a.m. at 76:17-25) ("Q. Was the MP I base numbers. . . would they have any part of this settlement in *Corbett*? . . . A. No. They were not part of the consideration for the settlement."); *id.* 01574-01575 at 77:25-78:7 ("A. You just asked me questions about whether *Corbett*—whether there was a validation hearing for MP I. Not that I know of. And *Corbett* certainly was not a validation hearing for MP I. Q. And it had nothing to do with MP I? . . . A. No, it had nothing to do with the consideration that was given for the settlement."); *id.* 01574 at 77:25-28 (*Corbett* "certainly wasn't a validation hearing for MP-1").

the disqualifying conflict and a new governmental action taken without participation of the disqualified officials or in compliance with the rule of necessity. *Id.* The MOUs and *Corbett* accomplished none of this: There was no disclosure of the prior violation and the conflicts of interest; indeed, the MOUs and the *Corbett* settlement were negotiated and approved by many of the same officials behind the scheme in MP I and MP II.

This ongoing—and substantial—involvement of the very individuals responsible for the unlawful benefits created under MP I and MP II ***confirms*** the City's ability to bring its present claims. Under well-established equitable principles, no actions purportedly taken on behalf of the City during the period such individuals adversely dominated the City can preclude a subsequent challenge to MP I and MP II, much less irretrievably validate these unlawful contracts.[20]

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[20] *E.g.*, 1 Ann Taylor Schwing, *California Affirmative Defenses* § 25:52 (2006 ed.) ("Entities that are controlled by the wrongdoer are not capable of bringing an action for the wrong during the pendency of that control. . . . This tolling rule is based on the logic that the corporation cannot have meaningful knowledge or notice of the wrongdoing by its controlling persons until it is freed from the control of the wrongdoers.") (citing *United States Liability Ins. Co. v. Haidinger-Hayes, Inc.*, 1 Cal. 3d 586, 596 (1970))."); *see also*, *e.g.*, *Smith v. Super. Ct.*, 217 Cal. App. 3d 950, 954 (1990) ("A statute of limitations tolls when a claim arises from a director's or employee's defalcation and the wrongdoers' control makes discovery impossible"); *Burt v. Irvine Co.*, 237 Cal. App. 2d 828, 867 (1965) ("[I]t is generally held that an action for fraud committed against a corporation is tolled for that period that those responsible for the fraud remained in control of the corporation").

The trial court fundamentally misunderstood the City's argument that the 1998 MOUs and *Corbett* could not preclude this action because of the ongoing involvement of people who had prohibited financial interests in MP I and MP II. The trial court misconstrued the City's argument as an attempt to bring new claims that were not alleged in the complaint. Ex. 11 at 00374 (Decision at 40:4-9). The City was not attempting to bring new allegations against unnamed officials; rather, the City sought the trial court's finding as to whether the same people who procured MP I and MP II also negotiated the

In sum, the court's conclusion that the illegal MP I benefits were validated s*ub silentio* through the *Corbett* settlement or subsequent MOUs is erroneous as a matter of law—subsequent agreements cannot ratify a Section 1090 violation.[21]

c. The Court Erred in Finding that Corbett Superseded MP I

Intermingled with the concepts of preclusion by judgment and ratification by contract is the trial court's related notion that the *Corbett* settlement ***superseded*** MP I by substituting new retirement benefits in lieu of those adopted in MP I. Ex. 11 at 00339 (Decision at 5:3-6) ("the court concludes the City cannot go back and undo the MP 1 benefits since those benefits were replaced by the City's creation of benefits for all pension participants in the *Corbett* judgment"). Although inchoate, the reasoning apparently is that these superseding arrangements render a dispute regarding the legality of MP I moot. This, too, is legal error.

First, the concept of adopting a superseding contract (whether settlement agreement or MOU) is a different way of saying that the City officials ratified or waived the prior illegality by subsequent contract, which, as shown, cannot be done. *E.g.*, *City*

1998 MOU's and *Corbett*. Ex. 9 at 00258, 00260, 00262, 00263, 00264 (City's Objections to Proposed Statement of Decision at ¶¶ 5, 6, 10, 15, 17, 18, 21) (stating that the trial court did not resolve issue as to the ongoing participation of City officials who improperly made MP I and MP II agreements in subsequent MOU's and settlements).

[21] Indeed, the error in the court's decision on this issue is confirmed by the internal inconsistency arising from its holdings: The court holds that MP I and the benefits awarded thereunder were ratified by MOUs pre-dating and implementing the *Corbett* settlement, but the court would permit the City to proceed with claims based on MP II, notwithstanding that MP II came even later in time, and it, too, has been followed by subsequent MOUs.

Lincoln-Mercury Co. v. Lindsey, 52 Cal. 2d at 274 ("A party to an illegal contract cannot ratify it, cannot be estopped from relying on the illegality, and cannot waive his right to urge that defense"). While the court's theory is that the new MOU process or the *Corbett* settlement cured the prior violation because it was a new action by a new City Council vote, that "cure" is merely an improper ratification (approval without disclosure and voiding of the original wrongful action), not a true cure through the remedy required by law (voiding, disclosure and new action).

This distinction is not form over substance: The problem with MP I (and MP II), as shown in the lengthy factual recitation, is not just that the SDCERS Board members voted and enabled their own benefit increases. The problem is more insidious and pervasive in that the Board Members also installed a grossly underfunded pension system that lost funding ground and solvency over time. ***Subsequent action to approve additional benefit increases on top of the earlier illegal ones does not cure the fundamental financial instability, which arose because of the concomitant underfunding, that was built into the system and that remains today***. *Corbett* and the MOUs upon which the trial court relies did nothing to cure (or even address) the funding side of the illegality equation.[22]

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[22] *Gleason*, discussed *infra*, did address a portion of the funding shortfalls resulting from MP I and MP II, but as the trial court's decision recognizes, did not resolve all claims of underfunding because of the limitations on the scope of the *Gleason* class. Ex. 11 at 00339, 00368 (Decision at 5:22-28, 34:2-3). Moreover, the *Gleason* settlement addressed only the City's failure to make the actuarially required contributions in certain years and prevented underfunding on a going forward basis, it did not resolve the massive

The defect in this reasoning can be seen in the trial court's particular reliance on intervening MOUs and the suggestion that those MOUs impliedly ratified the illegal MP I benefits. *See* Ex. 11 at 00351 (Decision at 17:14-17) ("the benefits in effect at the time of the *Corbett* judgment arose under the 1998 MOUs and not the 1996-1997 MOUs alleged to be part of MP 1"); Ex. 11 at 00355 (Decision at 21 n.2) ("The 96-97 MP I MOUs were no longer in effect at the time of the Corbett judgment. They had been supplanted by the 1998 MOUs"). Intervening MOUs could not silently ratify the illegal MP I benefits because they do not address the funding side of the illegal action.

Moreover, the conclusion that the MOUs superseded MP I benefits in their entirety is belied by the fact that the later MOUs expressly incorporate the terms of the MP I MOUs. Ex. 70 at 02394-02396. *Accord* Ex. 11 at 00355 (Decision at 21 n.2) ("The evidence at trial was entirely consistent with the case law which confirms that each new MOU is a new contract with terms and conditions ***negotiated in light of the others***.").[23]

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accumulated debt that has resulted from the benefit increases and funding shortfalls built into the system when MP I and MP II were adopted.

[23] Moreover, the trial court ***twice*** misread the City's interrogatory responses. In its Proposed Statement of Decision, the Court stated that the City, in its discovery responses, did not list the 1998 MOUs as challenged. Ex. 9 at 00272 (Proposed Statement of Decision at 21). The trial court, however, failed to acknowledge that the interrogatory did not ask for challenged ***agreements***, but rather only for challenged ***ordinances***. Ex. 50 at 01828 (Ex. 1250.4) ("please identify, *by San Diego* ***municipal ordinance number***, . . . each and every benefit . . . which you contend is illegal.") (emphasis added). To correct the trial court's misunderstanding of the City's discovery response, the City explained that the interrogatory did not ask for a list of challenged agreements, but rather only for challenged ordinances. Ex. 9 at 00258-00259 (City's Objections at ¶ 7). The trial court then compounded the error: In its Decision, the court stated that the City's discovery response did not list the ***ordinances*** implementing the 1998 MOUs. Ex. 11 at 00355 (Decision at 21 n.2). That is wrong. The City's discovery response clearly lists the 1998

Second, the record incontrovertibly confirms that the MP I benefits did not cease to exist through the *Corbett* settlement; rather that settlement (and MP II later) expressly preserves the pre-*Corbett* (*i.e.*, MP I benefit structure in place), increasing the benefits in place and building upon that existing structure. As noted, *Corbett* granted a simple 7% ***increase*** in the retirement benefit payment of those who terminated their employment on or before July 1, 2000.[24]

As one member of the Union negotiating team confirmed, the MP I benefits were already in their pockets when *Corbett* was negotiated. Ex. 49 at 01705 (Tr. Oct. 31, 2006 p.m. (Testimony of John Thompson) at 32:24-28) ("Q. By the time that you got to Corbett in 2000, you already had the 1997 benefit in your pocket, correct? A. Yes, sir."). As to those who remained active employees on July 1, 2000, they, too, received an ***increase*** in their retirement factor. *See* Ex. 48 at 01662, 01663 (*Corbett* settlement at 7:8-18, 8:3-14, 8:24-28). Accordingly, it is simply impossible to find correctly that *Corbett* superseded MP I; it did not.

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ordinances as challenged. Ex. 50 at 01828 (Ex. 1250.4) (listing O-18520, enacted May 26, 1998, and O-18600, enacted November 10, 1998). Thus, the City has never accepted that MP I benefits were abolished *sub silentio* by 1998 benefits or 1998 MOUs.

[24] Ex. 45 at 01545 (Tr. Nov. 8, 2006 a.m. at 77:25-76:7) (Testimony of David Hopkins, the City's and SDCERS's outside counsel in *Corbett*) (explaining that "what *Corbett* settled for was the plaintiffs giving up their claims for those additional pay items to be added on in exchange for an increase in retirement benefits . . . . There was a negotiation that provided increased retirement benefits to both active employees and retired employees, and ***it was that increase that was the consideration for the settlement of Corbett*** . . . .") (emphasis added); *see also id.* at 01555 at 58:8-26 (explaining that the *Corbett* settlement entailed only a percentage increase factor, not any particular value to each individual beneficiary; the "increase remains the same" and "the consideration for the *Corbett* settlement was that increase.").

Indeed, throughout its discussion, the court recognizes that the effect of *Corbett* was to ***increase existing benefits***—not to put in place an entirely new top-to-bottom benefit structure that "superseded" MP I. *See also* Ex. 11 at 00351 (Decision at 17:18-22) ("Those already retired . . . as of July 1, 2000, were to receive a seven percent (7%) ***increase*** in their benefits. The retroactive portion (obviously calculated on their ***then-existing benefits***) was to be paid in lump sum and then-future benefits would go forward increased 7% over what they were at the time of the judgment") (citation omitted); *id.* at 00351 (Decision at 17:11-13) ("The [active] employees are given an option: they can accept a new "retirement factor," or a 10% ***increase in benefits*** using the retirement factors in effect as of June 30, 2000."); *id.* at 00352 Decision at 18:18 (settlement used a "percentage increase in benefits"); *id.* at 00352 (Decision at 18:23-24) ("The Corbett settlement and judgment were entered in May of 2000 and it repeatedly refers to benefits ***in effect at that time"***); *id.* at 00354 (Decision at 20:17-18) ("The *Corbett* judgment itself clearly states the settling parties are receiving increased retirement benefits . . .") (emphasis added).

Thus, the benefits illegally approved in MP I did not evaporate with subsequent events—they remained the benefit "foundation" upon which the subsequent *Corbett* benefit increase "house" was built. When subsequent MOUs and the *Corbett* settlement increased benefits above that faulty foundation (without disclosing, examining or curing the prior illegality), the foundation remained rotten, and its defects were not cured by layering on still more increases—that is nothing more than an alternative form of impermissible ratification.

Indeed, the court's decision bears this out: "[B]oth management and the employees used the old expiring MOU as the starting point for the new round of negotiations. The new MOU would then reflect ***the mix of old and new benefits produced by the negotiation process***." Ex. 11 at 00342 (Decision at 8:17-18) (emphasis added); *see also id.* at 19:21-22 ("the judgment had to be based on the benefits the retired were already receiving at the time . . . ."); *id*. at 00355 (Decision at 21:1-3) ("[t]he benefits in effect at the time of, ***and underlying, the Corbett judgment, including benefits funded under MP I,*** cannot now be set aside because doing so would invalidate the *Corbett* judgment.").

In other words, the original illegal benefit increases in MP I remain in place notwithstanding *Corbett*. This continuing viability of the pre-*Corbett* Factor is confirmed by the ordinance implementing the *Corbett* settlement. *See* Ex. 52 at 01858-01859 (Ex. 1193.11-12, Ordinance No. O-18835 (August 7, 2000)) (preserving option to elect use of prior "unmodified" factor).

The ongoing viability of the original, illegal benefits is also apparent from the face of the Ordinance later adopting MP II, as well as contemporaneous and subsequent documents. The MP II Ordinance set forth an increase in the General Members' retirement factors, which could be calculated in a number of ways: (1) "Old Factor"; (2) "*Corbett* Factor"; or (3) "New Factor." Ex. 28 at 00863 (Ex. 74.9) (Ordinance No. O-19121, November 18, 2002). The "Old Factor" is the June 30, 2000 basis, *i.e.*, the pre-*Corbett* amount. *Id.* at 00859, 00860, 00863 (Ex. 74.5-74.6, 74.9). Under MP II, adopted in 2002, long after the *Corbett* settlement, employees may elect to have their retirement benefits calculated under the Old Factor, the *Corbett* Factor ***or*** the New Factor. *Id*. at 00859, 00860 (Ex. 74.5-74.6).[25]

The current MOUs with the Unions maintain this formula, expressly providing that the "Old Factor" remains an alternative for calculating benefits. *See* Ex. 4 at 00076.08 (Memorandum of Understanding Between the City of San Diego and AFSCME, Local 127 (attached as Exhibit A to AFSCME Local 127's Complaint in Intervention filed August 1, 2005) at 7 (¶ A)) (General member may elect "to have his or her Allowance calculated using the Old Factors . . . or the Corbett Factors"). Thus, it is evident that *Corbett* did not supersede MP I and the benefits awarded thereunder.

Moreover, the court's finding that *Corbett* superseded MP I for "all" employees is incorrect on another ground. As the court is forced to recognize in a footnote, some employees retired pre-*Corbett* (and pre-1998 MOU) ***based on the terms of MP I***. Ex. 11 at 00355 (Decision at 21, n.2).[26] While *Corbett* provided those employees with a benefit

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[25] Other parts of MP II make evident that the 2000 *Corbett* settlement did not supersede MP I: It is clear that at the time MP II was agreed to in 2002, the participants believed MP I remained in effect notwithstanding the *Corbett* settlement. *See* Ex. 27 at 00848 (Ex. 1168, at ¶ 1 (MP II Agreement dated Nov. 18, 2002)) ("On June 7, 1996, the City proposed and the SDCERS Board of Administration ('Board') agreed to the City Manager's Retirement Proposal, as modified, ('Manager's Proposal') dated July 23, 1996"); *id*. at 00848 (*id.* at ¶ 6) ("On July 11, 2002, after due consideration, the Board approved modifications to Section 3 of the Manager's Proposal, contingent on an appropriate written agreement being entered into between the City and the Board"). *See also* Ex. 13 at 00592 (Ex. 276.205) (July 11, 2002 Board Minutes) at 4 (system actuary Roeder did not include *Corbett* contingent liabilities in models used to evaluate MP II); *id*. at 00612 (*id.* at 24) (employee urging that *Corbett* "alternative" be maintained).

[26] Ex. 11 at 00355 (Decision at 21, n.2) ("The grant of benefits by the City to its' [sic] employees challenged by the City as part of MP 1 were no longer in effect (***except***

increase (a percentage of their ***existing benefits***) to satisfy their *Ventura* claim, it is indisputable that those employees' retirement benefits remain predicated upon MP I. Ex. 11 at 00346 (Decision at 12:17-18 (*Corbett* "increased the ***existing benefits*** for the already retired by seven percent") (emphasis added)).

Nonetheless, despite repeated recognition that *Corbett* and intervening MOUs built upon (and hence did not supersede) illegal MP I benefits, ***which remain in place***, the trial court concludes that *Corbett* bars litigation regarding the legality of MP I benefits because *Corbett* ***replaced*** MP I by enacting new benefits:

> The position of the City in this litigation is not supported by the evidence of the intent of the parties from the *Corbett* judgment itself. The judgment clearly uses the benefits in effect as of June 30, 2000, as the basis for the computation of the "new" *Corbett* benefits. If the City's interpretation of *Corbett* is correct, one would have to postulate that the parties agreed upon increases of 7% and 10% with no reference point. Taking the City's interpretation of *Corbett* to the extreme, the 7% and 10% increases would apply to zero since the underlying benefits are void. This clearly contradicts the evidence of the intention of the parties from the judgment itself, as well as the City's own witnesses who testified the case settled for an ***increase in retirement benefits***.

Ex. 11 at 00353 (Decision at 19:1-9) (emphasis added); *see also id.* at 11 (Decision at 20:20-22) ("The most reasonable interpretation of the judgment that accords with the wording of the judgment itself and the facts in existence in May of 2000 is that ***new retirement benefits*** were created in *Corbett*"). That notion of entirely new ground-up benefits awarded in *Corbett* is facially inconsistent and wholly irreconcilable with the

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for those who retired under MP 1) since the new 1998 MOUs were in effect by the time the Corbett judgment was entered") (emphasis added).

court's repeated recognition that *Corbett* built upon, added to and increased the existing benefits already in place under MP I.

With this conclusion, the court appears to say that *Corbett* validated the earlier MP I benefits because *Corbett* awarded a percentage of those benefits and the increase and the percentage had to be on something—not on zero—so this settlement validated the entire benefit structure. However, even if that were true, as discussed, that approach is not a cure of the prior illegality because there was no disclosure of the violation or a re-vote with full information.[27] And, as the court is repeatedly forced to concede, the old MP I benefits were used to calculate the percentage increase—which formed the settlement consideration—and the settlement itself was only the increased benefit amount, not the entire award of total benefit amount. Notwithstanding *Corbett*, MP I is alive and well, a result that in no way undermines the consideration for the *Corbett* settlement.[28]

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[27] The trial court tries to answer this deficiency with an ***implied*** curative procedure. Ex. 11 at 00354 (Decision at 20:3-7) ("one would have to postulate that at the time the parties on all sides agreed to new Corbett benefits, they did so with no understanding of the cost and economic benefit of the new benefits. In other words, if the increases do not apply to and modify the benefits in existence as of June 30/July 1, 2000, what are they?").

[28] Contrary to the Court's suggestion that the City changed its position regarding the manner by which *Corbett* could stand and the illegal benefits could be invalidated, the City's position has remained constant throughout this litigation. Just as it argued at trial, the City showed at the hearing on its objections that the *Corbett* increase could be calculated based on then-existing benefits, including MP I benefits, and that amount applied to remaining legal benefits to preserve the consideration for the settlement. Ex. 10 at 00324-00326 (Reporters Tr., Jan. 11, 2007, at 42:12-44:20) (explaining that one may calculate the *Corbett* increase and then subtract the illegal benefits). Indeed, counsel for the City relied on the very same report one of its witnesses, Actuary Joseph

In short, rather than justifying the result, the court's recognition that *Corbett* was an ***increase*** over ***existing benefits*** which had their genesis in MP I simply confirms that *Corbett* rests on the faulty MP I foundation. To void the MP I benefits does not, as the court postulates, require that the court undo the *Corbett* judgment—the incremental increases awarded in lieu of *Ventura* benefits can be maintained upon remand to the City Council—it merely means that ***the underlying benefits*** which had their genesis in MP I must be voided and remanded to the City Council for new consideration.[29]

* * *

In sum, struggle as it might, the court cannot solve the fundamental problems with its analysis: *Corbett* never adjudicated the illegality of MP I benefits or conflicts of interest under Section 1090. Instead, with the same participants who had adopted MP I at the helm, *Corbett* and the intervening MOUs merely built on to the faulty foundation of MP I benefits. While the court tries to establish that *Corbett* entirely replaced the MP I benefits, that effort runs afoul of the incontrovertible fact that *Corbett* merely "increased" "existing benefits," and even if *Corbett* had replaced MP I benefits in their entirety,

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Esuchanako, used at trial, *id.* at 00324 (42:15) (citing Euschenko report, Trial Exhibit 1446), which demonstrates that the same argument and support were presented at trial.

[29] As the trial court notes, the City does not challenge the *Corbett* judgment. Ex. 11 at 00339 (Decision at 5:3-6); *see also* Ex. 72 at 02578 (Ex. 779.58) (City's interrogatory response stating that it does not challenge the *Corbett* judgment); Ex. 71 at 02497 (Ex. 1260.63) (same). The trial court has turned the City's interrogatory response that it does not challenge the incremental increase in benefits adopted by *Corbett* into an erroneous conclusion that the City thereby waived its entire challenge to MP I. This is a two-fold error. First, the Court itself recognizes that *Corbett* only increased the benefits above the prior base level, meaning that the lack of a challenge to *Corbett* means nothing about the challenge to the underlying benefits. *See supra* 75-79. Second, and more important, as discussed, Section 1090 violations are not subject to defenses of waiver. *Supra* at 61-72.

Corbett was not a proper validating procedure and it did nothing to erase the systemic debt that MP I embedded in the pension system. Even today, the illegality persists and demands corrective action through determination and disclosure of the illegality, voiding of the illegal benefits, balancing legal benefits with legally-required funding and legislative adoption through legal actions of a curative remedy. This in no way undermines the *Corbett* settlement because the City admittedly is not challenging the consideration paid for that settlement—a percentage of existing benefits to be awarded in lieu of *Ventura* benefits.

2. **THE TRIAL COURT ERRED AS A MATTER OF LAW IN HOLDING THAT THE CITY'S CLAIMS ARE LARGELY BARRED BY THE *GLEASON* SETTLEMENT AND JUDGMENT**

The trial court's misreading and misapplication of *res judicata* principles continued with its use of a subsequent settlement agreement to bar the bulk of the City's claims under MP II. That settlement arose out of the *Gleason* litigation, which in reality was three separate lawsuits, ultimately consolidated for purposes of settlement. As discussed, to determine whether a claim is barred under *res judicata* principles, courts must examine whether: (1) the cause of action or issue decided in the prior adjudication is identical with the one presented in the action in question; (2) there was a final judgment on the merits; and (3) the party against whom the plea is asserted was a party or in privity with a party to the prior adjudication. *Teitelbaum Furs, Inc. v. Dominion Ins.*

Co., 58 Cal. 2d 601, 604 (1962). These criteria are not satisfied with regard to the *Gleason* litigation.

a. The *Gleason* Settlement Does Not Bar this Case Because There is No Identity of Parties or Issues

To understand the utter impossibility of properly applying claim or issue preclusion to the City in this case based on the *Gleason* settlement, it is important to understand the issues and parties in each of the three separate cases. The City was a party only in *Gleason I* (*Gleason v. San Diego City Employees' Retirement System, et al.*, San Diego Superior Court Case No. GIC 803779). That case did not involve employee pension benefits or conflict of interest issues; it solely involved the claims regarding the pension system's ***funding***. *See* Ex. 11 at 00349 (Decision at 15:5-7) (*Gleason* complaint "alleged the funding relief granted in 1996 and 2002 violated the City Charter by allowing the City to contribute at less than the actuarially required level"). *See also* Ex. 54 at 01935 (Tr. Nov. 8, 2006 p.m. at 44:13-17 (Pestotnik testimony)); Ex. 55 at (Ex. 433).

In 2004, the City settled *Gleason I*, with an agreement which promised to make actuarially-required contributions to SDCERS commencing in 2006 and on an ongoing basis thereafter. *See* Ex. 55 (Ex. 433). Thus, although MP I and MP II were ***prospectively*** terminated as a funding mechanism, *Gleason* had no impact whatsoever on benefits:

MP I and MP II allegedly continue to obligate the City to fund—on an ongoing basis—past and future benefit increases resulting from those unlawful agreements.[30]

As for the other two cases, *Gleason v. San Diego City Employees' Retirement System, et al.*, San Diego Superior Court Case No. GIC 810837 ("*Gleason II*"); and *Wiseman v. Board of Administration of the San Diego City Employees' Retirement System, et al.*, San Diego Superior Court Case No. GIC 811756 ("*Wiseman*"), of those two, only *Gleason II* involved the conflict of interest issues. Critically, however, the City was not a party to *Gleason II*. *See* Ex. 11 at 00349 (Decision at 15:12) ("The City was not a defendant in this action").

Thus, in the only case that involved Section 1090 (*Gleason II*), the City was not a party; in the case in which the City was a party (*Gleason I*), there was no Section 1090 claim. The settlement agreement expressly recognizes this fact, providing that the **City was not a party to the *Gleason II* or *Wiseman*, but rather only was a party to *Gleason I*.** *See* Ex. 55 at 01993 (Ex. 433.3, ¶¶ 5, 6); *see also* Ex. 54 at 01942 (Tr. Nov. 8, 2006 p.m. at 58:24-25) (Testimony of Timothy Pestotnik, outside counsel for the City in *Gleason*) (stating that the City was not a party to *Gleason II*); *id.* at 01935 (Tr. Nov. 8, 2006 p.m. at 43:3-18) (Section 1090 and *Gleason II* and *Wiseman* were not litigated or settled); *id.* at 01955 (Tr. Nov. 8, 2006 p.m. at 83:2-14) ("1090 was not a claim the City was facing"; "the only thing that changed was the funding mechanism"); *id.* at 01935 (Tr.

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[30] The Unions' argument and the court's finding that MP I and MP II were terminated with the *Gleason* settlement is facially inconsistent with the Unions' assertion that they have ongoing rights to the benefit increases conferred by MP I and MP II.

Nov. 8, 2006 p.m. at 44:10-21) (*Gleason I* was solely an underfunding case; the City and SDCERS were codefendants in that case and SDCERS did not have a claim against the City). Because it was not a party, the City is not bound by the settlement of *Gleason II*—the only case to raise Section 1090 issues, as the trial court recognized. Ex. 11 at 00370 (Decision at 36:4-9); *see also Am. Bankers Ins. Co. v. Avco-Lycoming Division*, 97 Cal. App. 3d 732, 737 (1979) ("A dismissal with prejudice in one case, however, does not result in the termination of all litigation involving the same facts. It is a judgment on the merits only as between the plaintiff in that case and defendants.").

Notwithstanding the fact that the City was not a party to the only case that raised the legality of the benefits issue, however, the trial court nonetheless held that because the City failed to challenge the legality of the pension benefits as a compulsory cross-claim in *Gleason I*, the City was barred under *res judicata* by the *Gleason* settlement from pursuing a claim as to most of the MP II benefits at issue. Ex. 11 at 00339-00340 (Decision at 5:24-6:2). Only as to those pension beneficiaries who retired after July 2004, and who therefore were not included in the *Gleason* class may the City proceed to assert its cause of action that MP II violated Section 1090 under the court's decision. *Id.* This application of *res judicata* is erroneous as a matter of law.

The sole issue in *Gleason I* (the only case in which the City was a party) was the whether the City had underfunded the pension system by failing to make the annual employer contribution determined by the SDCERS actuary and approved by the SDCERS Board. As noted, conflicts of interest and the legality of benefit increases were not at issue in *Gleason I*. *See also* Ex. 11 at 00342 (Decision at 8 n.1) ("As used in the

Gleason litigation, the terms [MP I and MP II] appear to have referred to the SDCERS contribution relief only," not "the employee retirement benefit increases").[31]

Despite the lack of identity of issues, however, the trial court found the City barred from asserting its conflict of interest claim in this case under the "should have been raised" bar/merger aspect of claim preclusion. The court reasoned that because the City asserts in this case that underfunding and benefit increases were a *quid pro quo* and inextricably linked in MP I and MP II, the City was required to assert its illegality of benefits claim as a compulsory cross-claim in response to plaintiffs' underfunding claim in *Gleason I*. Ex. 11 at 00339-00340 (Decision at 5:18-6:2); *id*. at 00366-00367 (Decision at 32:28-33:2).

The fundamental problem with this analysis, however, is that SDCERS, the target of the City's illegal benefit claim in this action, was the City's ***codefendant*** in *Gleason I*. Ex. 11 at 00366 (Decision at 32:4-5) (*Gleason I* included a plaintiff class of retirees and former employees whose pension benefits were funded under MP I and MP II, ***with SDCERS and the City as defendants***.") (emphasis added). Thus, SDCERS and the City

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[31] *See* Ex. 11 at 00349 (Decision at 15:27-28) ("Mr. Pestotnik confirmed the *Gleason* settlement eliminated the under funding provisions of MP 1 and MP 2. He also testified it did not deal with the benefits enacted by the City"); Ex. 54 at 01936 (Tr. Nov. 8, 2006 p.m. at 46:4-8) (Testimony of Timothy Pestotnik) (stating no recollection of any effort in connection with *Gleason* to validate the terms of MP I); *id.* at 01953 (Tr. Nov. 8, 2006 p.m. at 79:2-9) (*Id.* at 79:2-9) ("Q. So your recollection is that you never made the mayor and city council aware of the allegations of a 1090 violation? A. . . . I was not asked to brief [City officials] on 1090 and its application to . . . *Gleason I* because it wasn't alleged in *Gleason I*."); *id*. at 01955 (Tr. Nov. 8, 2006 p.m. at 83:5-10) (*id.* at 83:5-10) (explaining that "1090 was not a claim that the City was facing," . . . "so the City wasn't eliminating any risk on 1090 by virtue of settling with this class.").

were both defendants in that case and co-parties—not adverse parties. *See* Ex. 56 (Ex. 961); *see also* Ex. 54 at 01935 (Tr. Nov. 8, 2006 p.m. at 44:10-17) (Testimony of Timothy Pestotnik, outside counsel for the City in *Gleason*) (stating that the City and SDCERS were co-defendants in *Gleason I*).

The law is clear that the failure to bring a cross-claim against a codefendant will not support a *res judicata* bar in a subsequent lawsuit. *See Sutton v. Golden Gate Bridge, Highway & Transportation Dist.*, 68 Cal. App. 4th 1149, 1155 (1998) ("collateral estoppel does not apply against parties who were codefendants in a former action."); *Pleasant Valley Canal Co. v. Borror,* 61 Cal. App. 4th 742, 769 (1998) ("Ordinarily, therefore, where the plaintiff and defendant in the subsequent action were merely codefendants in the original action, the prior judgment cannot be used by one against the other as an estoppel since they were not adversary parties in the original action and no issues were raised or adjudicated between them therein.") (quoting *Great Western Furniture Co. v. Porter Corp.*, 238 Cal. App. 2d 502, 509 (1965)); *Atherley v. MacDonald, Young & Nelson, Inc.*, 135 Cal. App. 2d 383, 385 (1955) ("[I]n no event is a judgment in an action in which the parties were not adversaries, but only joined as codefendants, res judicata as between them in a later proceeding."). *Cf. Am. Bankers Ins. Co.*, 97 Cal. App. 3d at 735 ("As between defendants, the cross-complaint is not compulsory; it is only compulsory between plaintiffs and defendants."). *Accord* Ex. 11 at 00365 (Decision at 31:22-23) ("A party against whom a complaint is filed and served must assert in a cross-complaint any related cause of action he or she has against ***the plaintiff***") (emphasis added).

The court glosses over this established rule, merely stating that "[w]ell established California law requires ***the parties*** in litigation to bring all claims relating to the same transaction into the action litigating the legality of the transaction." Ex. 11 at 00339 (Decision at 5:18-19) (emphasis added). The court states that the City failed to challenge the MP I and MP II transactions "when the City had a legal duty to do so," *id.* at 00339 (Decision at 5:25), ignoring the established law holding that the City had no legal duty whatsoever to assert claims ***against codefendant SDCERS***, the defendant in this case.

Here, the City's claims are against SDCERS. There can be no contention that SDCERS and the plaintiff beneficiaries in *Gleason* were in privity in that prior litigation; the beneficiaries sued SDCERS in *Gleason I* and they were ***adversaries***. Reduced to its essentials, the court's ruling is that the City's claims ***against SDCERS*** are barred because of claims the City failed to assert against entirely separate, adverse and absent parties—the *Gleason I* plaintiffs—a clear error.

Indeed, the trial court's ruling that *Gleason I* bars the City's claims in this action because the City did not bring a compulsory cross-complaint in that action is particularly troubling when it is realized who the parties to this litigation ***are not***. First, the City had no legal duty in *Gleason* to assert claims against the Unions, ***who were not parties at all in Gleason I.*** Ex. 11 at 00349 (Decision at 15:3-17) (describing *Gleason* parties). Second, as the court discussed in its "necessary parties" ruling, addressed below, many of the individual pension beneficiaries ***have not been named as individual defendants in this case***. Yet the court's *res judicata* theory is that the City's claims are barred because the City failed to assert a compulsory cross-claim against the pension beneficiaries, who were class plaintiffs in *Gleason I*, but who are absent from this case. Thus, under the court's reasoning, the City's claims in this action are barred because the City failed to assert a claim in prior litigation against persons ***who are not parties to this case***. Ex. 11 at 00364-00365 (Decision at 30:28-31:6) ("***if*** the court ordered joined the absent, but necessary, participants from *Gleason I* in this action, the *Gleason* settlement and judgment would bar the City's claims against such individual participants in this action under the doctrine of res judicata because the City's claims in this action would have been the subject of a compulsory cross-complaint in *Gleason I*") (emphasis added).

The court cites no authority for the novel proposition that claim preclusion applies to defeat claims in a subsequent case between ***different parties***. Rather, the essence of claim preclusion is that it applies in subsequent litigation between the same parties or their privies. *See, e.g.*, *Border Business Park, Inc. v. City of San Diego*, 142 Cal. App. 4th 1538, 1563, 49 (2006) ("In its primary aspect the doctrine of res judicata [or 'claim preclusion'] operates as a bar to the maintenance of a second suit between the ***same parties*** on the same cause of action.") (quoting *Kelly v. Vons Companies, Inc.*, 67 Cal. App. 4th 1329, 1335 (1998)) (emphasis added).

In sum, because it ignores both who is the defendant here (SDCERS) and who was not a party in *Gleason I* (the Unions and all pension beneficiaries), the court's finding that the *Gleason* settlement bars the City's claim here under *res judicata* is clear error—not only is there no identity of issues (because the legality of pension benefits was not in issue), but there is no identity of parties, and certainly no obligation for the City to bring a "compulsory" cross-complaint against either co-parties or non-parties.

b. The *Gleason* Settlement Agreement Confirms That *Res Judicata* Does Not Bar the City Claims Here

The terms of the *Gleason* settlement itself also preclude a finding of *res judicata*: Unlike the plaintiffs, the City did not provide releases in the *Gleason* settlement. The release states:

Mutual Release

> Effective upon Court approval of this Agreement and the settlement, and in full, complete, and final compromise and settlement of any and all claims, ***Plaintiffs***, individually and on behalf of the Settlement Class, and each member of the Settlement Class, together with their children, heirs, successors in interest, and assigns ***hereby release***, discharge and dismiss with prejudice the City and SDCERS and/or their respective successors in interest, assigns, employees, agents, trustees, administrators, and representatives, … from any and all claims, actual or potential that arise from the facts alleged in the complaints in the Actions, any existing or potential claims relating to the City's past annual contributions, to SDCERS . . . .

Ex. 55 at 02003 (Ex. 433.13 (¶ 4) (emphasis added). The City and SDCERS were co-parties, as defendants, and did not release their claims. *Id.*; *see also* Ex. 54 at 01935 (Tr. Nov. 8, 2006 p.m. at 44:10-21). By its plain terms, then, the *Gleason* settlement does not specify that the City releases any claims arising out of MP I and MP II, nor in particular its Section 1090 claims against codefendant SDCERS.

Moreover, the *Gleason* settlement expressly disclaims any determination of liability on the part of the City. *See* Ex. 55 at 02005-02006 (Ex. 433.15-16 (¶ 8)) ("This Agreement, its constituent provisions, and any and all drafts, communications and discussions relating thereto, ***shall not be construed as or deemed to be evidence of an***

admission or concession by any party, including the City or SDCERS, and ***shall not be*** offered or ***received in evidence*** . . . in these Actions or any other action or proceeding ***as evidence of such [an] admission*** or concession. Instead, the purpose of this Agreement is to accomplish the compromise and settlement of disputed and contested claims. ***Nothing in this Agreement shall be construed as an admission by any party to this Agreement of any liability of any kind to any other party to this Agreement***. Each party to this Agreement denies the allegations of each other party as set forth in the Actions and further denies that such party is liable to the remaining parties in any respect whatsoever for the harm or damages that may have been sustained by any other party relating to the Actions, or the circumstances set forth in the Recitals section above.") (emphasis added).

This express limitation on the City's liability also precludes a finding of *res judicata* against the City. *See Clovis Ready Mix Co. v. Aetna Freight Lines*, 25 Cal. App. 3d 276, 284-85 (1972) (holding first corporation's settlement with employee of second corporation, followed by entry of judgment of dismissal with prejudice was not *res judicata* barring subsequent lawsuit by first corporation against second corporation arising out of same event where release in settlement of first lawsuit expressly disclaimed determination of liability); *see also Bleeck v. State Bd. of Optometry*, 18 Cal. App. 3d 415, 429 (1971) (same). *See generally* 1 Ann Taylor Schwing, *California Affirmative Defenses* § 14:17 (2006 ed.) ("The litigants or the court may exclude issues from the [res judicata] category of those that might have been litigated. In such a case, the judgment is not res judicata or collateral estoppel as to the deliberately excluded issues").

c. *Res Judicata* and Collateral Estoppel Do Not Preclude Full Litigation of This Case Because of the Intense Public Interest in This Matter

Finally, *res judicata* does not bar a claim when such a finding is against the public interest. "[W]hen the issue is a question of law rather than of fact, the prior determination is not conclusive either if injustice would result or if the public interest requires that relitigation not be foreclosed." *Arcadia Unified Sch. Dist. v. State Dep't of Educ.,* 2 Cal. 4th 251, 257 (1992); *see also Kopp v. Fair Pol. Practices Comm'n*, 11 Cal. 4th 607, 622 (1995) ("we conclude this is a matter in which the public interest requires that relitigation not be foreclosed, and hence reject the claim that the doctrines of res judicata or collateral estoppel bar consideration of the state law issue in this litigation"); *City of Sacramento v. State of California*, 50 Cal. 3d 51, 64 (1990) (explaining public interest bar to foreclosing litigation); *Chern v. Bank of America*, 15 Cal. 3d 866, 873 (1976) (there is a "sound judicial policy against applying collateral estoppel in cases which concern matters of important public interest"); *Ewing v. City of Carmel-By-The-Sea*, 234 Cal. App. 3d 1579, 1586 (1991) (refusing to apply collateral estoppel in a challenge to a zoning ordinance because the public interest in zoning warranted revisiting the issue).

Plainly, given the strong policy behind Section 1090, and in the interests of the public and the integrity of the legislative process, it is imperative that the serious and devastating conflicts of interest in this case be exposed to the light of judicial examination on their merits, and not swept under the procedural carpet.

3. **THE TRIAL COURT ERRED AS A MATTER OF LAW IN RULING THAT THE CITY CANNOT PURSUE A CLAIM THAT THE DEBT LIMIT LAWS WERE VIOLATED**

In addition to violating Section 1090, the benefit increases under MP I and MP II, and related changes in the Municipal Code, created unfunded City debt in violation of the liability laws which require same year debt to be matched with same year revenue in violation of state and local debt liability limit laws. *See* California Constitution, Article XVI, § 18; San Diego City Charter § 99 (collectively "Debt Limit Laws").[32]

a. **The Evidence Establishes Violations of The Debt Limit Laws**

The *San Francisco Gas Co.* case sets forth a mandatory rule: "[N]o indebtedness or liability incurred in any one year shall be paid out of the income or revenue of any future year." *San Francisco Gas Co. v. Brickwedel*, 62 Cal. 641, 642 (1882).[33]

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[32] Article XVI, Section 18 of the California Constitution provides that "No county [or] city . . . shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year" without a two-thirds vote of the electorate. Charter Section 99 provides that "[t]he City shall not incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year . . . ."

[33] The Debt Limit Laws establish the "pay as you go" principle as a cardinal rule of municipal finance. *San Francisco Gas Co.,* 62 Cal. at 642. As explained by the California Supreme Court, the framers of the California Constitution specifically created liability limits to avoid floating indebtedness:

> The system previously prevailing in some of the municipalities of the State by which liabilities and indebtedness were incurred by them far in excess of their income and revenue for the year in which the same were

As that case further emphasizes, "it must be remembered that all are presumed to know the law, and that whoever deals with a municipality is bound to know the extent of its powers." *San Francisco Gas Co. v. Brickwedel*, 62 Cal. 642-43. Thus, however unfortunate the results may be, the consequences of this mandatory rule do not limit or affect implementation of the law: "The fact that great hardships result in individual cases from an observance of the rule has been recognized in several of our decisions, but as has been well said, 'this fact cannot afford reason for subverting the law or frittering it away.'" *Arthur v. City of Petaluma*, 175 Cal. 216, 224 (1917).

As the extensive factual recitation showed, *see supra*, at 10-11,13, 15, 19, MP I, MP II, and related actions violated the Debt Limit Laws, a fact confirmed by the Phase I trial evidence.

As to MP I, Union negotiator John Thomson observed, "they were just gonna pay for it over time . . . ." Ex. 49 at 01729 (Tr. October 31, 2006 p.m. at 56:12-18). Bruce Herring, a Board member and Deputy City Manager, also testified that MP I decreased contributions below the actuarial required contribution rate and at the same time increased benefits. Ex. 31 at 00992 (Tr. November 15, 2006 a.m. at 90:6-11). He

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> contracted, thus creating a floating indebtedness which had to be paid out of the income and revenue of future years, and which, in turn, necessitated the carrying forward of other indebtedness, was a fruitful source of municipal extravagance. The evil consequences of that system had been felt by the people at home and witnessed elsewhere. ***It was to put a stop to all of that, that the constitutional provision in question was adopted.***

Id. (emphasis added).

acknowledged that the unfunded liability of the system would eventually be paid off "over the amortization period . . . at the later years . . . in the end . . . ." In other words, "they were postponing the full payment." *Id.* at 00992 (Tr. November 15, 2006 a.m. at 90:12-21). MEA's Italiano, too, confirmed the unfunded liability. Ex. 23 at 00800 (Tr. November 7, 2006 p.m. at 100:21-24).[34]

As to MP II, Richard Vortmann, another SDCERS Board member, testified that "[v]ery clearly in regard to the pension and in the worse with the retiree health, that the City was not paying its bills currently. They were referring liability into the future." Ex. 31 at 00908 (Tr. November 15, 2006 a.m. at 6:6-9). He further testified that the City was incurring liability "today and pushing off the payment of those [liabilities] to the future years." Ex. 31 at 00908 (Tr. November 15, 2006 a.m. at 6:10-11). *See also* Ex. 57 at

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[34] *See also* August 17, 2006 Italiano Deposition Testimony referring to MP I: "We agreed to allow the City to ramp up their payments over a period of time in return for an improvement in benefits." Ex. 30 at 01363 (Ex. 2205, at 4, clip 3 (222:19-21)).

She understood the City was creating more debt that was going to be paid later. *Id.* at 01363 (Ex. 2205, at 4, clip 4 (197:22 -198: 02)).

> Q: So you understood what you were doing here was agreeing to postpone the payment of the pension benefits to taxpayers in later years?
>
> A: Correct. So that the taxpayers could get service immediately, they were going to pay later down the road.
>
> Q: Well, the same taxpayers wouldn't be paying later, would they?
>
> A: I have no idea. Probably not.

Ex. 36 at 01364 (Ex. 2205, at 5, clip 4 (198:10-19)). Italiano also testified that the reason she agreed to postpone the contributions was because "that was the way we were going to get the benefits." *Id.* at 01364 (Ex. 2205, at 5, clip 8 (223:17-23)).

02035 (Ex. 371.2) (Vortmann letter stating: "The problem is very simply that the city does not want to pay currently for what they want to give the employees. They clearly are addicted to the 'give now, pay later' or 'burden the future year's taxpayers' when they no longer have any say in the decision – i.e., the decision being locked down now, with the mandatory bill being paid later." (emphasis in original.) *See also* Ex. 36 at 01363 (Exhibit 2205, Italiano Deposition Excerpt at 197:22-198:4, at 4, clip 4) ("Q. Was it your understanding that essentially you were, by doing this, agreeing to basically create more debt that the City was going to have to pay later? A. I did not—yes, I understood that the City was going to defer part of what was owed, yes. Q. And who was going to pay for that? A. The City.").

Instead of funding these retroactive and future benefits in 1996 and 2002, when they were incurred, SDCERS entered into contribution deferral agreements authorizing payments of tens of millions of dollars less to the pension system than was required by law. *See*, *e.g.*, Ex. 13 at 00523 (Ex. 276.136) (Minutes of the SDCERS Board meeting of June 21, 1996) (SDCERS Board member Ann Parode said MP I appeared to be a borrowing of money from the fund and inquired whether the Board's obligation in managing this fund should include future generations as well as today's employees and retirees); *see also id.* at 00524 (Ex. 276.137) (Minutes of the SDCERS Board meeting of June 21, 1996) (Ms. Parode said that the Board needs to ensure that the City is not deferring a liability that in due course it would have a more difficult time paying in the future. She asked that Dwight Hamilton, the Board's fiduciary counsel, research the question of whether she should have some concern about the City's ability to pay this burden in the year 2008).[35]

b. <u>The Trial Court Completely Misread the Debt Limit Laws</u>

Despite this wealth of evidence that the Debt Limit Laws were violated, in perhaps the starkest legal error in its decision, the trial court ruled that "the *Gleason* settlement ***ended*** the contribution relief by SDCERS and thus the City's reliance on setting aside the benefits under the debt limit laws by suing SDCERS alone, is unavailing." Ex. 11 at 00340 (Decision at 6:21-22) (emphasis added). That holding completely misapprehends the provisions of the Debt Limit Laws and what they prohibit.

As can be seen from their provisions, *see supra* n.32, these laws prohibit the ***creation*** of debt without corresponding revenue. It is incontrovertible that in MP I and MP II, the SDCERS Board approved and enabled benefit increases without corresponding sources of funding (indeed, while reducing the available funding in the system). It is this ***creation*** of unlawful debt that is the focus of the City's claim. The trial court's conclusion that "the only possible offending actions attributable to SDCERS have already been rescinded," Ex. 11 at 00364 (Decision at 30:22-23), is completely irrelevant to whether illegal debt was created through the actions of SDCERS in the first

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35 The City did not in fact pay any money to fund the benefits, and the allegedly surplus earnings were retirement fund assets, and not City money. As MEA President Judith Italiano testified: "Q. Where was the money going to be made up that wasn't being contributed as was required by the actuarial computation? A. . . . I think we were all expecting from what we knew about it was that the earnings of the system were . . . going to grow," and "as everyone made their contributions and the assets grew, that it would equal out at the end." Ex. 23 at 00766-00767 (Tr. Nov. 7, 2006 p.m. at 32:21-33:14).

instance. There is no suggestion by anyone that damage caused by SDCERS's actions in approving and enabling the unlawful benefit increases has been undone—that is the primary source of the staggering pension deficit, which is between $1 billion and $1.4 billion.

Completely ignoring its own findings as to SDCERS's role in creating the illegal benefits, the court writes: "The responsibility of SDCERS in the transaction was to allow the underfunding. Yet, the underfunding allowed by SDCERS already has been set aside in the *Gleason* settlement. Therefore, the portion of the transaction that involves SDCERS and its alleged contribution to the debt has already been undone." Ex. 11 at 00364 (Decision at 30:6-10). This is gross error: Aside from being factually incorrect,[36] the trial court's finding that the 2004 *Gleason* settlement ***ended*** the underfunding of the pension system, is totally irrelevant to whether, in 1996 and again in 2002, the Debt Limit Laws were violated by the ***adoption*** of unfunded benefit increases, which unquestionably occurred when SDCERS approved MP I and MP II. Indeed, the notion that the Debt Limit Laws prohibition was solved by the City ***paying more money*** through the *Gleason* settlement is ludicrous. The court cites no authority for its unfounded reading of the Debt Limit Laws, and there is none.

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[36] According to the allegations of numerous parties against the City, *Gleason* did not resolve all issues against the City relating to underfunding. As the Decision notes, the City was sued again for underfunding arising out of MP I and MP II in the *McGuigan* lawsuit. Ex. 11 at 00350 (Decision at 16:4-5). More to the point, SDCERS has filed a compulsory cross-complaint in this lawsuit, alleging that the City has underfunded the pension system as a result of MP I and MP II.

The court also suggests that the City may not sue SDCERS for violations of the Debt Limit Laws because SDCERS "does not set benefits and has no power to either set or rescind benefits." Ex. 11 at 00362 (Decision at 28:27-28). There is no question under the evidence, however, that the SDCERS Board adopted the benefit increases in question and enabled the City to increase the benefits by permitting the underfunding. Indeed, as the court itself writes later in the decision, "***the City produced extensive evidence in Phase One of the trial that shows that the City's grant of benefits in MP 1 and MP 2 were contingent upon the grant of funding relief by the SDCERS Board***." Ex. 11 at 00366 (Decision at 32:24-26) (emphasis added); *see also* Ex. 58 at 02041 (SDCERS Compulsory Cross-Complaint at 4, ¶ 16) ("Both the Former [SDCERS] Board and the City Council adopted MP 1"). Thus, SDCERS was responsible for the benefit increases at issue, and regardless of the *Gleason* settlement's partial, after-the-fact resolution of underfunding, the City is entitled to proceed to a determination of the merits as to the unlawful creation of that debt.[37]

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[37] The court's conclusion that SDCERS cannot be sued for violating the Debt Limit Laws because SDCERS did not set the benefits is wholly at odds with its express recognition that SDCERS enabled the illegal benefit increases. *Compare* Ex. 11 at 00363 (Decision at 29:15) ("SDCERS has no power to create these benefits") *with id.* at 00343 (Decision at 9:16-20) (stating that the evidence established that the benefits were contingent upon SDCERS's approval and were enacted after SDCERS granted approval) *and id.* at 00366 (Decision at 32:20-22).

c. **<u>An Actual, Justiciable Controversy Exists Between the City and SDCERS Over Whether a Violation of the Debt Limit Laws Occurred</u>**

The trial court committed yet another egregious error by ruling that "the City's claim in the 5ACC that SDCERS violated Constitutional Article XVI, section 18 and/or Charter section 99 does not give rise to a justiciable controversy since the real parties are not before the court or subject to the allegations in the causes of action." Ex. 11 at 00364 (Decision at 30:19-22). That ruling fails to appreciate the nature of the relief the City seeks—declaratory—and ignores the very real, very live controversy between the City and SDCERS over whether the creation of benefits under MP I and MP II violated the Debt Limit Laws.[38]

Declaratory relief is an equitable remedy that is available to an interested person[39] in a case "of actual controversy relating to the legal rights and duties of the respective parties . . . ." *East Bay Mun. Utility Dist. v. Dep't of Forestry & Fire Protection*, 43 Cal. App. 4th 1113, 1121 (1996). "The fundamental basis of declaratory relief is the existence of an actual, present controversy over a proper subject." *Levi v. O'Connell*, 144 Cal. App. 4th 700, 706 (2006) (quoting *City of Cotati v. Cashman*, 29 Cal. 4th 69, 79 (2002));

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[38] The City emphasized its position that an actual controversy exists at the hearing on its objections to the trial court's Proposed Statement of Decision. Ex. 10 at 00286-00289 (Reporter's Tr., Jan. 11, 2007, at 4:25-5:7, 5:28-7:10).

[39] There is no doubt that the City is an interested person—it is facing a financial crisis of the gravest kind as a result of the benefits it claims were passed in violation of the Debt Limit Laws.

see also Cal. Civ. Proc. Code § 1060 (A person may bring an action for declaratory relief "*in cases of actual controversy* relating to the legal rights and duties of the respective parties").

Critically, the actual controversy requirement "does not mean that the plaintiffs must allege and prove an actual breach of duty or a pattern or practice of past violations; ***rather, it is sufficient to allege that there is a controversy over <u>whether</u> a past breach or violation of the law had occurred.***" *See* Dennis Helmer, 26 Cal. Jur. 3d *Declaratory Relief* § 13 (2006); *see also Alameda County Land Use Ass'n v. City of Hayward*, 38 Cal. App. 4th 1716, 1723 (1995) (holding that a challenge to the validity of an MOU states an actual controversy when the parties "dispute whether a public entity has engaged in conduct . . . in violation of applicable law.").

California Alliance for Utilities Safety and Educ. v. City of San Diego, 56 Cal. App. 4th 1024 (1997), is particularly instructive in demonstrating that where, as here, the parties dispute whether a public entity has violated the law, that dispute ***alone*** sustains an action for declaratory relief. In *California Alliance*, the parties disputed whether the City Council had violated the city charter and the Brown Act, Cal. Gov. Code § 5490, by holding closed sessions to discuss the electric company's duty to lay power lines underground. *Id.* at 1029-30 ("there can be no doubt that there is a controversy between the parties over whether in reducing SDG&E's undergrounding obligation . . . the city council met the requirements of the Brown Act and the city charter."). The Court rejected the City's argument that there was no controversy, explaining that the parties' antithetical positions over whether the City had complied with the relevant laws was a controversy, and "[o]n that basis alone, plaintiffs are entitled to declaratory relief resolving the controversy." *Id.* at 1030.

Just as in *California Alliance* and *Alameda County Land Use Association*, the two parties here take opposite positions over whether a violation of the applicable law has occurred. The City and SDCERS fundamentally disagree over whether the creation of pension benefits under MP I and MP II violated the Debt Limit Laws. The City contends, as stated above, that the benefits created via MP I and MP II violated the Debt Limit Laws. *See, e.g.*, Ex. 1 at 00007 (5ACC at ¶¶ 30, 31); Ex. 10 at 00288 (Reporter's Tr., Jan. 11, 2007 Hearing, at 6:3-5) ("And we take the position, oh, yes, it did violate the liability limit laws, and we don't owe you the money."); Ex. 6 at 177-178 (City's Proposed Statement of Decision, at 82-83). The position of SDCERS (and, indeed, the Intervenors), is precisely the opposite: that the MP I and MP II benefits did not violate the Debt Limit Laws. *See, e.g.*, Ex. 73 at 02611-02614 (SDCERS's Memorandum of Points and Authorities in Support of Demurrer to 5ACC, at 8-11) (arguing that "MP I, MP II, and the pension benefits enacted 'in conjunction with' them did not violate the debt limit laws"); Ex. 74 at 2653-2660 (SDCERS's Memorandum of Points and Authorities in Opposition to the City's Motion for Summary Judgment of, Alternatively, for Summary Adjudication, at 28-35) (same). That dispute constitutes an actual controversy sufficient for declaratory relief. *See, e.g.*, *California Alliance for Utilities Safety and Educ.*, 56 Cal. App. 4th at 1030; *Alameda County Land Use Ass'n*, 38 Cal. App. 4th at 1723.

The definite and concrete nature of the claimed violation further confirms that declaratory relief is appropriate. The "actual controversy" requirement is closely intertwined with ripeness. *See* Helmer, 26 *Cal. Jur. 3d Declaratory Relief* § 13 ("Whether an actual controversy exists is thus a determination of the 'ripeness' of the controversy."). As the evidence shows, *see supra* at 6-45, 95-97, the City's claims are not conjectural, hypothetical, or merely anticipated. *See, e.g.*, *Santa Teresa Citizen Action Group v. City of San Jose*, 114 Cal. App. 4th 689, 708 (2003) (differentiating a ripe case from a case in which an opinion would have to be based on hypothetical facts). Rather, the City's claims are based on the specific and tangible facts surrounding the creation of the benefits. No guesswork is required to apply the Debt Limit Laws to the facts and, consequently, the controversy is fully ripe for review.

Because there is a justiciable controversy, it is irrelevant, contrary to the trial court's view, ***who*** violated the Debt Limit Laws (SDCERS or other City officials). *See* Ex. 11 at 00363-00364 (Decision, at 29:15-30:18). A declaratory action merely determines the parties' "rights and duties . . ., including a determination of any question of construction or validity arising under the instrument or contract." Cal. Civ. Proc. Code § 1060; *see also East Bay Mun. Utility Dist*, 43 Cal. App. 4th at 1121 (declaratory relief is available to in a case "of actual controversy relating to the legal rights and duties of the respective parties . . . ."). A declaratory judgment does not assign blame or even compensate an injured party. Thus, so long as the parties have rights or duties that relate to one another, for purposes of a declaratory action, it is irrelevant whether the defendant violated the law. Here, the duties and obligations of SDCERS and the City are intimately related: This declaratory relief action will determine whether SDCERS has a duty to continue paying benefits and using City funds to do so, or whether the City has the right to roll back the illegal benefits and to prevent SDCERS from continuing to pay them. A justiciable controversy exists and it is immaterial whether SDCERS, or some other entity, is the wrongdoer.

The errors in the trial court's analysis of whether there was an actual controversy did not end there: The trial court further erred by turning a blind eye to the public interest in the issues. Although the public interest is not dispositive in determining the justiciability of a claim, it should be considered and weighed in favor of resolving the issue. *See, e.g.*, *California Alliance for Utility Safety and Educ.*, 56 Cal. App. 4th at 1030 (evaluating justiciability and stating that "[a]lthough the public importance of an issue is not controlling, we must recognize . . . the public interest in resolving this controversy is substantial"); *accord Abbott Laboratories v. Gardner*, 387 U.S. 136, 148-49 (1967) (stating that justiciability requires a court to evaluate "both the fitness of the issues for judicial decision and the hardship to the parties of withholding court consideration") (*overruled on other grounds in Califano v. Sanders*, 430 U.S. 99 (1977)); *BKHN, Inc. v. Dep't of Health Servs.*, 3 Cal. App. 4th 301, 309 (1992) (stating that ripeness is requires a court to evaluate both the fitness of the issues for judicial decision and the hardship to the parties of withholding court consideration). The City and public at large have tremendous interest in resolving whether the Debt Limit Laws were violated. The trial court's refusal to adjudicate the question, based on its erroneous understanding of justiciability doctrines, deprives the public of any legal certainty regarding the validity of the benefits and, in turn, creates the risk that illegal benefits will continue to be paid, pushing the City ever closer to financial catastrophe. These hardships, the result of a refusal to consider the issues, weigh in favor of adjudicating the Debt Limit Law claims.

d. SDCERS is Part of the City and, Therefore, the Debt Limit Laws Apply to It

The court also suggests that SDCERS may not be a "city" within the meaning of California Constitution, Article XVI, Section 18 and City Charter Section 99. Ex. 11 at 00363 (Decision at 29:2-13). While the court's opinion rightly recognizes that SDCERS is bound by the City Charter and California Constitution, Ex. 11 at 00362 (Decision at 28:24-25) ("the City Charter and California Constitution define the duties and responsibilities of SDCERS"), the court nonetheless finds that because SDCERS "is a public retirement system" "and is not the city of San Diego," "these sections do not apply to SDCERS." *Id*. at 00363.

However, it is incontrovertible under the Charter that SDCERS ***is*** a department of the City, and therefore part of the City. *See* S.D. Muni. Code § 22.180(b) (City departments include the City Retirement Board). The trial court previously has ruled that SDCERS is a department of the City. Ex. 59 at 02073 (March 6, 2006, Summary Adjudication Order, at 3). Accordingly, the court's finding that the Debt Limit Laws do not apply to SDCERS because SDCERS is not a "city" is erroneous as a matter of law.

In any event, the Court misses the mark because the issue is not whether SDCERS qualifies as a "city," but rather whether SDCERS is causing the City to incur debts and liabilities in excess of its annual revenue, and thereby causing the City to violate the Debt

Limit Laws. Because the answer is "yes," the City must bring this action against SDCERS to stop further illegal payments. Both the California Constitution and the San Diego Charter prohibit cities from incurring indebtedness or liabilities "***in any manner***" that exceeds income or revenue for that year. Cal. Const. art. XVI, § 18; Charter, art. VII, § 99. SDCERS' distribution of illegal benefits is the manner by which the City's debts are accruing in excess of its revenue: By continuing to distribute the illegal benefits, and obligating the City to fund those benefits, the Board is causing the City to incur liabilities greater than its income in violation of the Debt Limit Laws. The only way the City can comply with the Debt Limit Laws is through this lawsuit, the result of which would force the Board to stop distributing the illegal benefits.

Alternatively, the court suggests that if SDCERS is part of the City "then the City is suing itself for relief" and this "does not constitute an appropriate justiciable controversy under the unique facts and circumstances of this case." Ex. 11 at 00363 (Decision at 29:12-13). The court cites no authority, however, for the proposition that one agency of a public entity may not sue another governmental agency, and the unsupported holding that such a controversy is not "justiciable" is erroneous as a matter of law. *See City Council v. McKinley*, 80 Cal. App. 3d 204, 207 (1978) (City Council petitioned for a writ of mandamus against the city manager and the city auditor and comptroller); *see also* Cal. Civ. Proc. Code § 1021.5 (permitting an award of attorney fees to a prevailing public entity in actions involving "enforcement by one public entity against another public entity . . . ."); *see generally* 3 Eugene, McQuillin, The Law of Municipal Corporations § 12.52.05 (3d ed. 2006) ("The relation existing between a city attorney and the city council is not, in all respects, that of attorney and client; the city attorney is the law officer of the city, but is not the servant of the city council. . . [I]n all matters that merely concern the public, which are for the preservation of morals, maintenance of good order and the abatement of public nuisances, the city attorney is wholly independent of the city council, is a servant of the people, and as to such matters, vested with powers and burdened with duties over which the council has no jurisdiction."); San Diego City Charter, art. V, § 40, ¶ 5 (stating the City Attorney's obligation to prosecute all "offenses against the laws of the State as may be required of the City Attorney by law"); *accord Federal Labor Relations Authority v. United States Dep't of Defense, Army and Air Force Exchange Service*, 984 F.2d 370 (10th Cir. 1993) (several departments of the federal government were adverse to several other departments of the federal government). Indeed, the court already has held in this case that although SDCERS is part of the City, it is an entity that is subject to suit by the City. Ex. 59, at 02072-02073, 02076 (March 6, 2006, Summary Adjudication Ruling, at 2, 3, 6).

While the City claims that the benefit increases under MP I and MP II violated the Debt Limit Laws, SDCERS contends that the Debt Limit Laws have not been violated. SDCERS has stipulated that it will be bound by the judgment of this Court as to this issue. Accordingly, there is a justiciable controversy between the City and SDCERS as to whether the Debt Limit Laws have been violated.

4. <u>THE TRIAL COURT ABUSED ITS DISCRETION IN CONCLUDING THAT THE ACTION COULD NOT PROCEED UNLESS NECESSARY PARTIES WERE JOINED</u>

California Code of Civil Procedure Section 389(a) defines parties necessary to an action:

> [A person] shall be joined as a party in the action if (1) in his absence complete relief cannot be accorded among those already parties or (2) he claims an interest relating to the subject of the action and is so situated that the disposition of the action in his absence may (i) as a practical matter impair or impede his ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk of incurring . . . inconsistent obligations.

Cal. Civ. Proc. Code § 389(a); *see generally Olszewski v. Scripps Health*, 30 Cal. 4th 798, 808-09 (2003).

Even if a determination of necessity under Section 389(a) is made, however, the Court has the broad discretion to maintain the action. *E.g.*, *Koster v. County of San Joaquin*, 47 Cal. App. 4th 29, 44 (1996). Section 389(b) states, "[i]f a person described in paragraph (1) or (2) of subdivision (a) cannot be made a party, the court ***shall*** determine whether in equity and good conscience the action should proceed among the parties before it . . . ." (Emphasis added). Courts "should, in dealing with 'necessary' and 'indispensable' parties, be careful to avoid converting a discretionary power or a rule of fairness in procedure into an arbitrary and burdensome requirement which may thwart rather than accomplish justice." *Bank of Cal. Nat'l Ass'n v. Super. Ct.*, 16 Cal. 2d. 516, 521 (1940). Parties should be joined "unless it is impossible to find them, ***or***

impracticable to bring them in. But it is a matter of discretion whether or not to proceed without them." *Leonard Corp. v. City of San Diego,* 210 Cal. App. 2d 547, 551 (1962) (emphasis added); *see also People ex rel. Lungren v. Cmty. Redevelopment Agency for City of Palm Springs*, 56 Cal. App. 4th 868, 875-76 (1997) ("It is for discretionary and equitable reasons, not for any want of jurisdiction, that the court may decline to proceed without the absent party.") (quoting *Kraus v. Willow Park Public Golf Course*, 73 Cal. App. 3d 354, 368 (1977)).[40]

Despite the discretion afforded to the trial court, the court held that the case cannot proceed unless the City joins every single pension beneficiary (totaling nearly 20,000 individuals) whose interests might be affected by this dispute. The court so held despite the fact that the Unions, which represented the employees' interests at the time MP I and MP II (and MOUs) were adopted, are already parties to the case, along with nearly 200 individual beneficiaries (the *Abdelnour* plaintiffs), and despite the fact that in the face of overwhelming media coverage, no other party has sought to intervene during the nearly two years this case has been pending. Ex. 11 at 00361 (Decision at 27:17-28).

Finding that all SDCERS beneficiaries are necessary parties to the case, and that it was practicable to join all these individuals, the court declined to consider exercising its

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[40] Among the factors the Court considers in exercising that discretion are:

- The extent to which prejudice may be avoided by protective measures;
- Whether the judgment rendered in the nonjoined person's absence will provide an adequate remedy to the parties before the Court; and
- Whether, if the action is dismissed for nonjoinder, the plaintiff will have an adequate remedy elsewhere.

See Olszewski, 30 Cal. 4th at 808; *Deltakeeper v. Oakdale Irrigation Dist.*, 94 Cal. App. 4th 1092, 1106-1108 (2001).

discretion to proceed without the absent parties under Section 389(b). *Id.* at 00362 (Decision at 27:10-11). With this ruling, the court has held that in order to obtain a judicial declaration that a particular government action is illegal under conflict of interest or debt limit laws, every potentially affected individual must be made a party to the lawsuit before the legal issue can be resolved. That is not the law and the court's requirement that every interested person be joined as a party to the case is a clear abuse of discretion.[41]

a. <u>All SDCERS Beneficiaries are Not "Necessary" Parties Under Section 389(a)</u>

(i) <u>Complete Relief Can Be Accorded Among the Parties</u>

As discussed in detail above, the City seeks to set aside contracts and legislative actions which were adopted in violation of multiple laws. Under the law urged by the City, contracts or legislation adopted in violation of such laws are not merely voidable, but void. Cal. Gov't Code § 1092. The City is also asking the Court to set aside official actions taken in violation of the Debt Limit Laws. Again, the remedy provided is to set aside the offending actions irrespective of the parties affected. *See*, *supra*, at 49-59.

If City officials violated the applicable provisions of law, the mandatory remedy requires that the official actions be set aside. ***That result does not vary based upon the***

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[41] The court's determinations as to whether parties are "necessary" under Section 389(a) or indispensable under Section 389(b) are reviewed for an abuse of discretion. *E.g., Kaczorowski v. Mendocino County Bd. of Supervisors*, 88 Cal. App. 4th 564, 568 (2001).

identity or interest of any absent parties: The law requires invalidation of the official action irrespective of the individual impact that would follow. Thus, under the laws cited by the City, a single party would be entitled to the relief sought if it be shown that the conflict of interest laws or Debt Limit Laws were violated. Given the appropriate judicial remedy (discussed *infra*), which entails a declaration of invalidity of official actions tainted by conflict of interest or other legal violations, and a remand to the legislative body for new proceedings, complete relief can be afforded among the parties before the Court without undue prejudice to absent parties.

Indeed, the law requiring invalidation—regardless of the absence of interested parties—comports with the well settled principle that third party beneficiaries to contracts are not necessary parties to actions implicating those contracts. *See, e.g.*, Cal. Civ. Proc. Code § 369(a)(3) (those who have made a contract for the benefit of another may sue without joining as parties the persons for whose benefit the action is prosecuted); *Ragan v. Sirigo*, 160 Cal. App. 2d 832, 834 (1958) ("If Murphy were a third party beneficiary under the contract, he still would not be a necessary party to the action."). By statute, a person who has entered into a contract for the benefit of another may sue ***without joining as a party the person for whom the action is prosecuted***. Cal. Civ. Proc. Code § 369(a)(3).

In this case, the trial court's decision was based, in part, on the Intervenors' complaints, which seek, *inter alia*, a judicial determination that SDCERS may legally continue paying benefits. *See* Ex. 3 at 00065 (*Abdelnour* Plaintiffs' First Amended Complaint for Declaratory Relief, at ¶ 23); Ex. 2 at 00041, 00052 (MEA Complaint in

Intervention at 1:22-23, 1:26-28, 12:11-17); Ex. 4 at 00073 (AFSCME Local 127's Complaint in Intervention, at 3:24-26). Thus, because the Intervenors, who entered into MOUs that led to the contested benefits, are prosecuting claims that benefit not only themselves, but also the absent beneficiaries, those beneficiaries need not be joined. *See* Cal. Civ. Proc. Code § 369(a)(3); *see also Chase v. Van Camp Sea Food Co.*, 109 Cal. App. 38, 46 (1930) (where contract for fishing and cleaning fish was in father's name, father could maintain action alone, even though contract would benefit son); *In re Marriage of Smith & Maescher*, 21 Cal. App. 4th 100, 106 (1993) (third party beneficiaries are not indispensable parties to a promisee's action to enforce a contract) (applying Massachusetts law). As one treatise explains, plaintiffs may bring suit against parties to a contract without joining third parties for whose benefit the contract was made, here, the absent beneficiaries. *See* 67A C.J.S. *Parties* § 51 (2006).

Moreover, in cases of public interest such as this, traditional rules of party joinder do not apply. As the Ninth Circuit Court of Appeals wrote in *Kettle Range Conservation Group v. U.S. Bureau of Land Management*, 150 F.3d 1083 (9th Cir. 1998):

> It appears clear that if, as appellants urge, the only "complete" relief the district court could grant was to rescind the already executed contracts and invalidate the private entities' title to the transferred land, those private entities would, ordinarily, be necessary parties under Rule 19. The federal courts have, however, recognized a "public rights exception" to the usual rules of joinder when "litigation . . . transcends the private interests of the litigants and seeks[s] to vindicate a public right . . . . ***[In cases] involving the protection and enforcement of public rights "there is little scope or need for the traditional rules governing the joinder of parties in litigation determining private rights***."

Id. at 1086-87 (citations omitted) (emphasis added).

California law follows the same rule. *See People ex rel. Lungren v. Cmty. Redevelopment Agency*, 56 Cal. App. 4th 868, 882-83 (1997). As that court wrote:

> [T]he interest the public has in obtaining some level of review of the actions of the Agency in transferring property and placing it beyond the reach of the state's police power is sufficiently important that it provides an exception to the general application of the rule, under section 389, that an action challenging a contract should be dismissed if a party to the contract cannot be joined as a party . . . . [T]his court must recognize the interests of the citizens . . . in providing some review of the power of a local agency to permanently relinquish its interest in property within its control.

Id.

Because the remedy discussed below is one that confines the relief to the broad question of the unlawfulness of the official action and then provides for remand for further legislative, administrative or judicial proceedings as appropriate, the trial court erred in refusing to decide the conflict of interest law and Debt Limit Law issues—arguably the most portentous legal questions in San Diego's history. Moreover, it is wholly illogical to rule that beneficiaries are necessary parties in a Section 1090 case when they are not accused of violating 1090. Indeed, the beneficiaries could not violate Section 1090 as they are not government officials. Simply put, there is no reason to require the impractical joinder of thousand upon thousands of people whose absence does not prevent the court from adjudicating the issues.[42]

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[42] Not only can complete relief be afforded among those already parties through a declaration that MP I and MP II are void for violation of conflict of interest and Debt Limit Laws, but that declaration would eliminate the prospect that the existing parties

(ii) The Unions and Other Parties Represent the Absent Parties and Therefore The Absent Parties' Interests are Protected

The ability of the absent parties to protect their interests is not impaired or impeded by this action because they are well represented by multiple existing parties. Parties are not necessary under Section 389(a) when they already are fairly represented by existing parties to the action. *See Citizens Ass'n for Sensible Dev. of Bishop Area v. County of Inyo*, 172 Cal. App. 3d 151, 161 (1985); *see also Deltakeeper*, 94 Cal. App. 4th at 1102 (a nonjoined party's ability to protect its interest is not impaired or impeded as required by Section 389(a) when a joined party has the same interest in the litigation). Here, the absent parties—pension beneficiaries—are well represented by the existing parties—including the Unions, SDCERS and the *Abdelnour* Plaintiffs.[43]

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would be subject to inconsistent obligations. Upon determination that MP I and MP II are void, the City can assert that binding adjudication under collateral estoppel in subsequent litigation. Moreover, both SDCERS and the City have agreed to assume the risk of inconsistent adjudications, if any. Hence, the court's summary conclusion, without analysis or authority, that proceeding would "leave SDCERS and the City subject to the substantial risk of incurring multiple or inconsistent obligations. . . ." Ex. 11 at 00358 (Decision at 24:22-23), is without foundation.

[43] The trial court found that SDCERS, despite its role as trustee for the pension system and fiduciary for the beneficiaries, did not represent the beneficiaries because of its tactical to decision to sit out the Phase I trial, Ex. 11 at 00356 (Decision at 22:7-12). However, SDCERS remains a party to this case and has its own compulsory cross-complaint. Ex. 58 at 02041 (SDCERS's Compulsory Cross-Complaint at ¶ 14) (MP I "allowed the City to contribute less funds than what was actuarially required pursuant to Charter Section 143 by promising that retirement benefits certain members of the Former Board . . . would be entitled to receive would be increased"). There is no suggestion that SDCERS will not participate in Phase III of the trial relating to the actual existence of a

Given principles of representational standing, the Unions have standing to sue and to obtain binding determinations on behalf of their individual members (and even those who are not members), and therefore the individual employees and beneficiaries do not need to be parties to the litigation. *See Int'l Union, United Auto., Aerospace & Agricultural Implement Workers of Am. v. Brock*, 477 U.S. 274, 287-90 (1986). In *Brock*, the United States Supreme Court addressed associational standing by unions in cases brought on behalf of their members and representing their members' individual interests. The Court held that the unions had standing to litigate the legality of legislation impacting union members, even without the joinder of the members in the lawsuit. *Id.* Because the lawsuit turned upon a question of statutory interpretation, and because the application to individual members' benefits would have to be considered by proper state authorities before the member could receive the benefits allegedly due him, the union could "litigate this case without the participation of those individual claimants . . . ." *Id.* at 288. Indeed, the Court noted, one of the advantages for an employee in joining a union is that members may pool capital and resources and thereby obtain better legal representation of their interests than a member could obtain individually. *Id.* at 289-90. Thus, under established federal rules of representational standing, unions may seek a determination on behalf of their members as to their individual rights to benefits under law. *See also Rhode Island Bhd. of Corr. Officers v. Rhode Island*, 357 F.3d 42, 48-49 (1st Cir. 2004) (union had standing to seek declaration on behalf of its members as to

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Section 1090 violation. Likewise, the 194 *Abdelnour* Plaintiffs represent individual non-union employees and retirees. Ex. 11 at 00357 (Decision at 23:3-9).

whether Contract Clause protected rights to particular pay under alleged individual contracts; held no such protection applied because contracts did not give rise to obligation).

The same rule governs under California law. In *Professional Fire Fighters, Inc. v. City of Los Angeles*, 60 Cal. 2d 276, 284 (1963), for example, the court held that the union could seek declaratory and injunctive relief for discrimination against individual union members. The court wrote:

> [U]nions such as plaintiff may be organized for the sole purpose of representing their members. An action at law on behalf of such members is one form of such representation . . . . [Plaintiff union's] members are all employees of the fire department and as such have a clear beneficial interest in the subject matter of the complaint. ***Its interest is joint with theirs.***

Id. at 284 (emphasis added). *See generally Int'l Fed'n of Prof'l & Technical Eng'rs v. City & County of San Francisco*, 79 Cal. App. 4th 1300, 1308 n.9 (2000) ("MEA clearly had standing to involve itself on its members' behalf in the legal proceedings").

In such cases, ***representational standing is the equivalent of class action representation***, and class action procedure, including notice to individual class members, is superfluous. *See Glendale City Employees' Ass'n v. City of Glendale*, 15 Cal. 3d 328, 341 (1975) (in case under Meyers-Milias-Brown Act ("MMBA"), because plaintiff association could sue in its own name on behalf of members, class action format added nothing to rights or liabilities of parties, and "***the issue of notice to the members of the class is immaterial***") (emphasis added).

Nor does it matter that the subject of the litigation is the union members' claim to benefits or other entitlements of employment governed by the MMBA. *See generally* Cal. Gov't Code § 3504 ("the scope of [the unions'] representation shall include all matters related to employment conditions and employer-employee relations, including but not limited to wages, hours, and other terms and conditions of employment . . . ."). In *California School Employees Association v. Willits Unified School District*, 243 Cal. App. 2d 776, 780 (1966), the union's standing to sue on behalf of its members under the MMBA was challenged on the grounds that individual actions by the members were required because the individuals' interests were personal, and the evidence relating to the individuals' salary and damages would vary. Citing the public interest in the resolution of important statutory issues, the court rejected the contention that the union was an insufficient representative of the individual interests of its members in their perquisites of employment:

> [A]n organization which qualifies under [the MMBA has] standing to sue in its own name to enforce the employment rights of its members . . . . [T]he question [presented] is not only of common interest. . . , but it is of public interest, for the issues relate to interpretation of important statutes . . . [¶] ***Equally lacking in substance is the district's contention that individual actions should have been brought because the evidence relating to [the members] was different. It was different as to amounts of salary and perhaps other details, but not as to substantial issues, particularly when interpretation of the same statutes was essential to both cases***.

Id. (emphasis added). Having found jurisdiction to adjudicate the dispute with the union as the sole plaintiff, the court then proceeded to determine that the "award of back salary to one employee and damages for diminished income to the other cannot be sustained," *id*. at 787, making clear that jurisdiction lay to rule adversely to the employee union members in an action brought on their behalf by the union itself.

Particularly where, as discussed below, the remedy contemplated by the law is declaratory relief and mandamus, which will entail further legislative, judicial and administrative proceedings upon remand, the individual union members need not be joined. *See Bhd. of Teamsters & Auto Truck Drivers v. Unemployment Ins. Appeals Bd.*, 190 Cal. App. 3d 1515 (1987). In that case, the court followed the United States Supreme Court opinion in *Brock*, and held that the union had standing to litigate whether its employees were eligible for benefits, and that the employees need not be joined as parties to the lawsuit. *Id*. at 1521-24. Noting that state law on standing is "consistent with federal law," *id.* at 1521 n.3, the court wrote:

> Here, as in *Brock*, the mandate proceeding raises a pure question of law, i.e. whether the Board properly interpreted section 1262 in denying its benefits to the union member claimants. Although the Board may have to determine each claimant's benefits, the unions may litigate this case ***without the participation of its members*** and still insure that the remedy, if granted, will inure to the benefit of those union members who have been injured.

Id. at 1523 (emphasis added). *See generally* 8 B.E. Witkin, California Procedure 4th Writs § 77 (4th ed. 1997) (participation of individual union members not necessary for issuance of writ of mandamus).[44]

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[44] *Phillips v. State Personnel Board*, 184 Cal. App. 3d 651, 660 (1986), disapproved on other grounds, *Coleman v. Department of Personnel Administration*, 52 Cal. 3d 1102, 1123 n.8 (1991), cited by the trial court, Ex. 11 at 00359 (Decision at 25:18-19), for the

Asserting their desire for representational standing, the Unions moved to intervene in this case, specifically alleging that they represent the interests of their individual members. *See* Ex. 60 at 02079-02080 (San Diego City Firefighters, Local 145, Complaint in Intervention, dated August 2, 2005, Ex. 2188.2-3 (¶ 3)) ("Local 145 is the

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proposition that unions "cannot ***bargain*** away nor waive employees' individual constitutional rights," (emphasis added), is not on point. Here, the unions are representing employees' interests' in ***litigation***, which is precisely their function, and which binds the employees to adverse decisions affecting their common interests, as discussed. *Philips* does not establish that a union cannot represent its members in a lawsuit involving pension benefits. Nor does the trial court's lengthy discussion of agency theory overcome principles of representational standing. *See* Ex. 11 at 00359-00360 (Decision at 25:27-26:17). The cases it cites do not even consistently involve unions, but rather discuss whether an association can be liable—this, even though the City does not seek to hold the individual employees liable. *See Barr v. United Methodist Church*, 90 Cal. App. 3d 259 (1979); *Fazzi v. Peters*, 68 Cal. 2d 590 (1968) (not discussing representational standing, but construing specific statute, Cal. Civ. Proc. Code § 388, and holding that individual property of a partner cannot be bound by judgment unless partner is joined). The two cited cases involving unions merely note, in dicta, the general proposition that union actions are valid only as to common or group interests, and individuals do not incur obligations by virtue of joining associations. *See Marshall v. Int'l Longshoremen's & Warehousemen's Union*, 57 Cal. 2d 781, 787 (1962); *DeMille v. Am. Fed'n of Radio Artists*, 31 Cal. 2d 139, 149 (1947). These matters are either off point on the question whether an issue of common interest to all union members can definitively be resolved in litigation in which the members are represented by the union under representational standing principles. The notion that the City seeks to set aside some benefits but not others, making union members adverse to one another, Ex. 11 at 00361 (Decision at 27:1-3), is factually incorrect as to the City (the City seeks to set aside all MP I and MP II benefits), Ex. 1 at 00014, 00015, 00027-00030 (5ACC at ¶¶ 67, 70 and p. 27-30), and also an erroneous statement of the Unions' position, which is uniformly to support all benefits for all beneficiaries, *see*, *e.g.*, Ex. 2 at 00041 (MEA's Complaint in Intervention, filed August 10, 2005 at 1:26-28) ("MEA . . . opposes any claim that pension benefits heretofore adopted by the City Council . . .are 'illegal or void'. . . .); *id.* 00052 at 12:16-17 (requesting declaration that "all pension benefit improvements . . . be declared lawful"); Ex. 3 at 00067 (*Abdelnour* Plaintiffs' First Amended Complaint for Declaratory Relief, filed August 25, 2005 at 10:15-18) (seeking judicial determination that "SDCERS may properly and legally pay all City Retirement Benefits"); Ex. 4 at 00073 (AFSCME Local 127's Complaint in Intervention, filed on or about August 1, 2005 at 3:24-26) (seeking declaration that SDCERS may "properly and legally pay all City Retirement benefits").

certified bargaining representative for all employees of the City of San Diego in the Fire Fighter Unit . . . . Local 145 has a fundamental interest in preserving the City Retirement Benefits being challenged by Aguirre because it represents employees who have worked and are working for the City with the expectation of receiving those benefits . . . . Local 145 represents both safety members and general members of SDCERS whose vested retirement benefits have been challenged by Aguirre and are at issue in the Action").[45]

The Unions' Complaints specifically seek a determination that the benefits awarded under MP I and MP II are lawful. *See, e.g., id.* at 02080 (Ex. 2188.3 (¶ 6) ("The Contested Retirement Benefits were not enacted in violation of Government Code section 1090 or the Political Reform Act, Government Code sections 81000 et seq.").[46]

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45 *See also* Ex. 4 at 00072-00073 (AFSCME Local 127's Complaint in Intervention, filed August 10, 2005, Ex. 2189.2-3 (¶ 3a) (Local 127 is the exclusive bargaining representative for approximately 2200 active employees . . . . In its statutory capacity under the Meyer-Millias-Brown Act . . . Local 127 has the exclusive right and duty to represent all employees in the Unit regarding matters within the scope of representation, including retirement benefits"); Ex. 61 at 02089 (Declaration of Ronald L. Saathoff in Support of Firefighters, Local 145, *Ex Parte* Application to Intervene, at 8 (¶¶ 7, 9) (Local 145 "represents the employees who have worked for the City with the expectation of receiving those benefits. If Aguirre is successful, members of Local 145 will be deprived of retirement benefits . . . . [¶] Local 145 is the only entity authorized by law to represent the employment interests of firefighters"); Ex. 2 at 00042 (San Diego Municipal Employees' Association's Complaint in Intervention, filed August 10, 2005, Ex. 2190 at ¶ 1) ("MEA is a recognized employee organization within the meaning of the state's [MMBA]. Acting in this statutory capacity, MEA has negotiated a series of labor agreements, known as 'Memoranda of Understanding' (MOUs), with the City of San Diego on behalf of approximately 6,000 City employees . . . for whom MEA is the exclusive bargaining representative. These MOUs embody the results of MEA's good faith bargaining on all matters within the scope of representation as defined by law, including pension benefits.").

46 *See also* Ex. 61 at 02083 (*Ex Parte* Application by San Diego City Firefighters, Local 145, for Leave to Intervene, dated August 2, 2005, at 2)("Local 145 has a

The Court granted the motions to intervene, and the Unions (as well as the *Abdelnour* Plaintiffs) have been full participants and vigorous advocates for their members' interests in establishing the legality of the benefits, advocacy of which the beneficiaries are well aware. For example, Firefighter John Thompson testified in response to the question of whether the 1300 individual members of the Firefighters Union are in "some way a party to this case," that "I guess we all are as far as benefits." Ex. 75 at 02739 (Tr. Oct. 31, 2006 a.m. at 71:8-13). Thompson also testified that counsel for the Firefighters was protecting his interest in this litigation:

> Q. You have an interest in the outcome of this case today, do you not?
>
> A. Yes, sir.
>
> Q. Who is representing your interests in that?
>
> A. Mr. Klevens.
>
> Q. Okay. And it's your understanding that he's looking out for the overall interest of the Firefighters in this case.
>
> A. Yes . . . .

Ex. 49 at 1703 (Tr. Oct. 31, 2006 p.m. at 30:4-12).

Similarly, former MEA President Judith Italiano testified that the MEA members "are relying on us protecting the language that we fought for, that talks about their retirement benefits." Ex. 23 at 758 (Tr. Nov. 7, 2006 p.m. at 15:19-28). The MEA has

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fundamental interest in preserving the City Retirement Benefits being challenged by Aguirre because it ***represents the employees*** . . . . If Aguirre is successful, members of Local 145 will be deprived of retirement benefits . . . .") (emphasis added); Ex. 4 at 74 (AFSCME Local 127's Complaint in Intervention, filed August 10, 2005, Ex. 2189.4) (prayer for relief that the Contested Benefits are "lawful and enforceable in all respects").

told its members about the basic nature of the litigation, *id*. at 756 (*id.* at 11:26-28); how the case is proceeding before the Court, *id.* (*id*. at 12:1-5); that "our attorney is representing the organization's agreement with the City about our retirement," *id*. (*id*. at 12:22-27); and that the Union is looking out for their interest in this litigation, *id*. (*id.* at 12:28-13:9).[47]

With their participation guaranteed, the Unions and their members cannot have it both ways—claiming standing to establish the ***validity*** of the employees' benefits under MP I and MP II, but not the converse—to suffer a determination of the legal ***invalidity*** of such benefits under conflict of interest law or Debt Limit Laws. Rather, not only do the Unions have the standing to litigate on behalf of their employee members without joining such members in the lawsuit, but adverse as well as favorable decisions may obtain from such litigation. *See, e.g., San Bernardino Public Employees Ass'n v. City of Fontana*, 67 Cal. App. 4th 1215, 1223 (1998) (in litigation brought by union relating to employee benefits brought under MMBA, courts adjudicated rights of employees; appellate court held that trial court erred in holding that employees' rights in certain benefits were vested because public employees have no vested right in any particular measure of benefits); *accord In re Retirement Cases*, 110 Cal. App. 4th 426, 469-72 (2003) (in consolidated

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47 *See* Ex. 23 at 756-57 (Tr. Nov. 7, 2006 p.m. at 12:28-13:4) (Testimony of Judith Italiano) ("Q. Have you told the [union] members that . . . the union is looking out after their interest in this litigation? A. As it relates to what we have bargained in our MOU, yes."). *See also* (Declaration of Edward G. Lehman In Support of AFSCME's Ex Parte Application for Leave to Intervene, dated August 1, 2005, at 3 (¶ 4)) ("The employees represented by Local 127 are acutely aware of the current controversy concerning the lawfulness of the current SDCERS benefit structure . . . .").

action in which numerous cases had union as sole plaintiff, court determined that retirement boards had discretion to collect arrearages in contributions from plan members to fund contribution shortfall arising from board's mistaken interpretation of law); *Cal. Sch. Employees Ass'n v. Sequoia Union High Sch. Dist.,* 272 Cal. App. 2d 98, 103-104, 112 (1969) (association had standing to sue in litigation regarding employees' rights; court ruled adversely to affected employees); *California Sch. Employees Ass'n v. Willits Unified Sch. Dist.*, 243 Cal. App. 2d at 780, 788.[48]

Indeed, the unions represent ***all*** the employees and beneficiaries. *See* R. Weil, *et al.*, *California Practice Guide: Civil Procedure Before Trial* § 14:242 (The Rutter Group 2006) (for representative actions, labor unions are treated "specially"; they have "standing to sue on behalf of their members individually, and even on behalf of ***nonmembers***") (citing *Anaheim Elementary Educ. Ass'n v. Bd. of Educ.*, 179 Cal. App.

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[48] *Silver v. Los Angeles County Metropolitan Transportation Authority*, 79 Cal. App. 4th 338 (2000), cited by the court, does not overcome the rules on representational standing, a doctrine *Silver* did not consider. The facts in *Silver* were completely different—in *Silver*, the ***unions*** (petitioners) sought to recoup individual payments made by defendant/respondent governmental agency to certain employees from whom the governmental agency would have to recoup the payments if relief were granted. *Id.* at 346, 348. *Silver* merely held that the trial court did not abuse its discretion in weighing several considerations (not present here) and concluding that employees were indispensable parties. *Id.* at 349-50. Here, as discussed below, the City seeks a declaration as to the invalidity of administrative and legislative actions, and a remand to the legislative body for corrective proceedings—not a remedy against any individual employee or retiree for a return of monies paid. In contrast to *Silver*, where the failure to join additional parties threatened a multiplicity of proceedings and inconsistent judgments, a resolution in this case will reduce litigation by providing needed certainty as to respective rights under the law in the face of multiple federal and state court cases involving the same issues, and a productive remedy by way of remand to the authorized decision-making body. *See infra* at 131-134.

3d 1153, 1159 (1986)) (emphasis in original). *See also Relyea v. Ventura County Fire Protection Dist.*, 2 Cal. App. 4th 875, 882 (1992) ("It also is a fundamental principle that a member of an employee bargaining unit is bound by the terms of a valid collective bargaining agreement, though he is not formally a party to it and may not even belong to the union which negotiated it.") (citing *San Lorenzo Educ. Ass'n v. Wilson*, 32 Cal.3d 841, 846 (1982)).[49]

Given that the Unions and other parties adequately represent the interests of the absent beneficiaries, it was an abuse of discretion to conclude that the thousands of beneficiaries are each necessary parties. The court's authorities all relate to situations where the absent parties were not represented by the parties to the case.[50]

*   *   *

[49] *Compare* Ex. 11 at 00356 (Decision at 22:20-21) ("The evidence and law established the unions represent only current employees . . . ."). Under the court's reasoning, while the unions were capable of representing the employees and all system beneficiaries in approving MP I and MP II, *see* Ex. 11 at 00347, 00348, 00359 (13:1-13, 14:14-23, 25:17-18), and while the unions actively have intervened to obtain a declaration of the ***legality*** of those agreements on behalf of all beneficiaries, *id.* at 335 (*id.* at 1:22-26), *id.* at 359 (*id.* at 25:14-18), *see also, e.g.*, Ex. 2 at 52 (MEA's Complaint in Intervention at 12, filed August 10, 2005), they are incapable of representing the same interests if the court were to rule that the agreements are illegal.

[50] Ex. 11 at 00346 (Decision at 25:1-6). In *Tuller v. Superior Court*, 215 Cal. 352, 355 (1932), *Salazar v. Eastin*, 9 Cal. 4th 836, 860 (1995), and *Korean Philadelphia Presbyterian Church v. California Presbytery*, 77 Cal. App. 4th 1069, 1081 (2000), none of the existing parties to the lawsuit represented the absent parties. *Tuller*, 215 Cal. at 355 (deciding whether both mother and father were necessary in action by child for support); *Korean Philadelphia*, 77 Cal. App. 4th at 1083 (holding that no party had standing because only corporate shareholders, officers and directors have standing, and parties all were corporate outsiders).

In sum, because complete relief (a declaration of invalidity of official action) can be afforded among those who are parties, because that declaration is in the public interest, and because the absent parties' interests are fully represented so that their interests will not be impaired or impeded, the trial court erred in finding that absent parties are "necessary" within the meaning of Section 389(a). Upon finding that absent parties were necessary, the court then concluded that their joinder was practicable, and the court therefore declined to consider altogether whether it should exercise discretion to proceed under Section 389(b). Ex. 11 at 00361 (Decision at 27:10-12) (court would not consider Section 389(b) because "the affected individuals are known and subject to service of process"). This, too, was an abuse of discretion.

b. **Joinder of All System Beneficiaries is Impracticable and Unnecessary**

Just as all taxpayers do not need to be before the Court, all interested employees need not be parties. The impracticality of joining thousands of individuals—here, every employee, retiree, and beneficiary of the City retirement system—disfavors a determination that they are indispensable to the action. Rather, the "delay and expense" of joining so many (nearly 20,000) individuals is "oppressive and burdensome" and is therefore not required. *See Hebbard v. Colgrove*, 28 Cal. App. 3d 1017, 1026-27 (1972); *see also Deltakeeper*, 94 Cal. App. 4th at 1106-08 (in an action to set aside a contract, all parties to the contract are not indispensable parties; "the fact the action may affect the interests of the nonjoined parties in the underlying contract does not dictate the conclusion that they are indispensable parties").

In *Hebbard,* for instance, the court declined to require joinder of the beneficiaries in a trust fund suit "where the beneficiaries are very numerous, so that the delay and expense of bringing them in becomes oppressive and burdensome." 28 Cal. App. 3d at 1027; *see also People ex rel. Lungren*, 56 Cal. App. 4th at 882 (same). While the class action device theoretically is available, as discussed, such procedure is superfluous as to employees and beneficiaries when the unions are parties, *Glendale City Employees' Ass'n v. City of Glendale*, 15 Cal. 3d at 341, and particularly because the absent parties' interests are well represented, participation of each and every potentially interested and already represented individual in the context of this public interest litigation is not required. *People ex rel. Lungren*, 56 Cal. App. 4th at 882.

The trial court attempted to circumvent the impracticability of joining so many individuals by pointing to the narrowed scope of the lawsuit after its rulings that the *Corbett* and *Gleason* settlements bar the City's claims as to most of the pension beneficiaries. Ex. 11 at 00340 (Decision at 6:10-19). Because those rulings were erroneous as a matter of law, as discussed, the Court's finding that joinder is practicable, predicated upon those erroneous limitations of the scope of the case, is an abuse of discretion. Once the court's erroneous *Corbett* and *Gleason* "bars" are stripped away, there are 17,638 SDCERS beneficiaries who would have to be individually named, served and joined to the lawsuit. Ex. 11 at 00356 (Decision at 22:15). Such joinder is impractical and the court abused its discretion in failing to consider whether such parties were indispensable under Section 389(b). As discussed below, given the considerations weighing in favor of resolution—especially the public interest—they are not.

(i) <u>The Public Interest Favors Resolution of This Case</u>

Public interest considerations favor resolving the legality of pension benefits in this lawsuit. *See generally Bank of Cal. v. Super. Ct.*, 16 Cal. 2d at 521. Numerous public officials—including the City's Mayor—have urged a final judicial determination regarding the legal issues raised by MP I and MP II. Mayor Jerry Sanders submitted a declaration to the court stating that the lingering "cloud" of uncertainty over the City's finances, created by the issues related to the pension system, has limited the City's ability to obtain financing necessary to fund important public works projects, and to attract and retain talented public employees responsible for providing crucial City services. Ex. 62 at 02102 (Declaration of Mayor Jerry Sanders, June 12, 2006, at ¶ 2). Among the most important of these issues, and "a major impediment" to the Mayor's stated objectives, is the "continuing uncertainty as to the legality of certain benefit increases created under. . . [MP I and MP II] . . . ." *Id.* at 02102 (*Id.* at ¶ 3). The Mayor stated:

> 5. . . . I make this declaration to inform the Court, ***as the City's highest elected official, its chief executive officer, and as the head of City government, that the City needs and desires from this Court a determination as to the legality of the benefit increases under MP I [and] MP II*** . . . . The certainty provided by this Court's judicial determination will allow the City to move forward to ensure adequate funding to SDCERS based on the total amount of legal and valid benefits. Until that determination is made, it is enormously difficult for the City to quantify its present and future obligations and to match the City's revenue stream with its liabilities. As the leader of the City, and on behalf of the people of the City, I therefore respectfully ask this Court to . . . resolve the issues . . . .

Id. at 02103 (*Id.* at ¶ 5) (emphasis added).

Council President Scott Peters has also declared that a determination regarding the legality of the benefit increases under MP I and MP II, "will assist the City in quantifying its obligations and providing adequate funding for the pension system. . . ." Ex. 63 at 02105 (Declaration of City Council President Scott Peters, June 12, 2006, at ¶¶ 2-3). Council President Peters stated:

> I make this declaration to inform the Court that ***the City needs and desires from this Court an immediate and final determination as to the legality of the benefit increases under Manager's Proposals I and II*** . . . .

Id. at 02105 (*Id.* at ¶ 3) (emphasis added).

The other parties, too, have committed enormous resources to this lawsuit, and need and desire certainty, as evidenced by the allegations of their pleadings in this case, asserting that the dispute is justiciable, and seeking declaratory relief on the benefit legality issue.[51]

As discussed, there is a strong public policy favoring strict application of Section 1090, and vigorous enforcement of conflict of interest laws is in the best interests of all citizens. *Carson Redevelopment Agency v. Padilla*, 140 Cal. App. 4th at 1335. The

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51 *See, e.g.,* Ex. 74 at 02111 (*Ex Parte* Application of MEA for Leave to Intervene, dated August 2, 2005, at 6:16-17) ("MEA has a duty to act expeditiously and by all available means to eliminate the enormous uncertainty and anxiety that has been created by the actions and statements of City Attorney Michael J. Aguirre . . . ."); Ex. 3 at 00064 (*Abdelnour* Plaintiffs' First Amended Complaint, filed on or about August 23, 2006, Ex. 2187.10 (¶ 18)) ("a judicial determination of the legality of the Contested Benefits is necessary to resolve the present controversy. . . ."); *Id.* at 00065 (*id.* at 2187.11) (¶ 24)) ("[A] judicial determination is necessary and appropriate at this time so that the parties can ascertain their respective rights and duties").

taxpayers deserve their day in court on the merits of whether illegal actions of their public officials have saddled them with crushing public debt.

(ii) <u>Judicial Efficiency Favors Resolution</u>

Resolution is also in the interests of the judiciary and judicial efficiency. Substantial judicial time has been spent on this case. Proceedings in other courts—state and federal—may turn on the outcome of rulings in this case, which is by far the most advanced of the multiple civil pension cases. The absent parties primarily are members of the San Diego Police Department, who elected to file a parallel action in federal court. The judge in that case has indicated that the issues should be resolved in this state court action. *See San Diego Police Officers' Ass'n v. Aguirre, et al.*, Case No. 05CV1581-H (Transcript of Proceedings, Oct. 13, 2006 at 37-38) ("And on some of the issues, Superior Court Judge Barton will begin a trial . . . if the—some of the pension benefits were void and, if so, what, if anything, can be done about that. And since we are stating State Court cases the—I have full confidence that a Superior Court State Court judge would be able to read the applicable cases and law and State . . . Constitution in this matters just as well as this Court would.").[52]

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[52] Despite the federal court's deference to this case, the trial court nonetheless justified its necessary party ruling on the fact that the SDPOA's claims are pending in federal court. Ex. 11 at 00356-00357 (Decision at 22:27-23:2). Of course, the SDPOA or its members could have intervened in this action, as could any individual beneficiary, but they have elected not to do so.

In sum, Section 389 is a discretionary rule, meant to provide equity to those parties who should be joined and who could be joined. The universe of pension beneficiaries need not be joined to this lawsuit when they are well represented by multiple existing parties and they have not sought to intervene. The absent parties consist of some members of the City work force not represented by a municipal union and some City retirees who have chosen not to intervene in this action (others are represented by the *Abdelnour* Plaintiffs). The trial court erred as a matter of law in concluding that necessary parties are absent, and it abused its discretion in refusing to entertain the case under Section 389(b) because any absent parties are not indispensable.

5. **THE TRIAL COURT ERRED AS A MATTER OF LAW IN REJECTING THE REMEDY OF A REMAND TO THE CITY COUNCIL FOR NEW PROCEEDINGS**

The judicial remedy expressly mandated by state conflict of interest laws is that the court set aside the void agreement, transaction or legislation in its entirety. The court should remand the matter to the responsible public body (the City Council) for disclosure, rehearing and new proceedings on the issues of pension benefit increases and pension system funding, to be held free from the taint of the unlawful conflicts. That step, if desired, can then be followed by a judicial validating action, in which any remaining claims can be laid to rest in a single proceeding. This procedure has been employed in numerous conflict of interest cases.

In *Clark v. City of Hermosa Beach*, 48 Cal. App. 4th 1152 (1996), for example, plaintiffs raised a challenge to a decision of the city council based upon a conflict of interest. Applying state conflict of interest law, the court issued a writ of mandate and directed the city to rescind the council decision. Because plaintiffs were deprived of a fair hearing (*i.e.,* one free of the taint of conflict), ***the court held that the proper remedy was to remand to the council with directions requiring the council to rehear the matter and provide a fair hearing***. *Id.* at 1170-77.

Likewise, in *Downey Cares v. Downey Community Development Commission*, 196 Cal. App. 3d 983 (1987), the court held that the city's ordinance was invalid when an approving city council member had a conflict of interest, given that the redevelopment plan had a foreseeable material effect on his income as a realtor. The court therefore issued a writ of mandate invalidating the ordinance and issued an injunction restraining its enforcement. *Id*. at 988-89. The appellate court found that the trial court had properly invalidated the ordinance. *Id*. at 993, 998.

Other cases have employed similar approaches. *See also Kunec v. Brea Redevelopment Agency*, 55 Cal. App. 4th 511, 515 (1997) (affirming trial court's injunction invalidating decision of city council because two members had financial interests); *Witt v. Morrow*, 70 Cal. App. 3d 817, 820 n.1 (1977) ("when a violation has occurred, the court may set aside the official action as void"); *cf. Schaefer v. Berinstein*, 140 Cal. App. 2d 278, 289-93 (1956) (upon violation of Section 1090, city council had duty to declare resulting action void); *accord Carson Redevelopment Agency v. Padilla*, 140 Cal. App. 4th at 1337 ("Nothing stops [the parties affected by the set aside of the unlawful official action] from going to the City of Carson to work out a contract that is not tainted by a conflict of interest").

Thus, conflict of interest law provides the court with a justiciable remedy should an unlawful conflict of interest be found in Phase III: That remedy would be to declare the illegal official actions—including MP I and MP II and all inextricably related contractual and legislative actions—to be void, and to issue a writ of mandamus remanding the matter to the City Council for new proceedings cured of the invalidating conflict.

Once the City Council conducts fair proceedings, the City can then (if necessary) obtain approval of the corrected action in a judicial validating proceeding, *see* Cal. Civ. Proc. Code §§ 860, *et seq*., which allows all interested persons to be heard, and which operates *in rem* and thereby yields a judgment that is binding and conclusive against the agency and all other persons. *Id*., § 870(a); *see also Embarcadero Mun. Improvement Dist. v. County of Santa Barbara*, 88 Cal. App. 4th 781, 789 (2001) ("'The purpose of the validation statutes is to provide a simple and uniform method for testing the validity of government action'") (quoting *Moorpark Unified Sch. Dist. v. Super. Ct.*, 223 Cal. App. 3d 954, 960 (1990)). The validation action is designed to obtain a prompt and complete decision regarding the validity of a public entity's action, thereby avoiding litigation delay and uncertainty that may impair the entity's ability to operate financially. *Friedland v. City of Long Beach*, 62 Cal. App. 4th 835, 842-43 (1998). The Validation Act procedure is not limited to bonds or other financial instruments, but extends to situations where the lack of a prompt validating process would impair the public agency's ability to operate. *E.g., Graydon v. Pasadena Redevelopment Agency*, 104 Cal. App. 3d

631, 644-45 (1980). That is precisely the procedure that has been employed and affirmed on appeal in analogous circumstances.[53]

That remedy was supported by the trial testimony. For example, Mr. McGrory testified that he learned of the corrective steps needed to resolve instances in which City officials voted on matters in which they had a financial interest. Ex. 32 at 01036-01037 (Tr. Nov. 6, 2006 p.m. at 49:17-51:13). Mr. McGrory explained: "Well, the Council had voted on an item in which they had—had a potential to benefit from that, in some way, then that would have been a conflict, and it would not have been appropriate for them to have voted, so the Council would revote the item, with that Council member taking a walk and abstaining." *Id*. at 01036-01037 (*id.* at 50:27-51:5). Mr. McGrory also explained that the revote would take place after full disclosure about the conflict of interest. *Id.* at 01037 (*id.* at 51:6-8).

While reserving ruling on the remedy, Ex. 11 at 00376 (Decision at 42:16-17), the court suggested that the City's proposed remedy of declaring a statutory violation, voiding the resulting government action and remanding to the City Council for curative proceedings was unworkable. Ex. 11 at 00371 (Decision at 37:16-21). Because that is the remedy provided by law for conflict of interest violations, the court should be directed to impose that remedy if the City succeeds on the merits.

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[53] *See City of San Diego v. Furgatch*, 2002 WL 1575109 (4th Dist., Div. 1, July 17, 2002) (unpublished disposition) (after rehearing matter tainted by conflict of interest in earlier decision, city and redevelopment agency brought validating action for judicial declaration of validity of curative procedure). (An unpublished opinion may be considered for the value and persuasiveness of its analysis or reasoning. *See Modern Dev. Co. v. Navigators Ins. Co.*, 111 Cal. App. 4th 932, 943 (2003)).

V.

CONCLUSION

This Court's decision on this Petition is of enormous importance to the entire City. Immediate appellate intervention is needed to remove the shadow of legal uncertainty and to illuminate the path to fiscal predictability and soundness. The City requests that this Court issue a writ of mandate vacating the trial court's Decision and directing that the court enter a new order finding that this case is justiciable, that all necessary parties are joined, and that the case should proceed to trial on the merits of the remaining phases as to all aspects of MP I, MP II and the Debt Limit Laws.

Only in this way can the trial court address the conflict of interest and legality issues that have been tendered by the parties before it, and ensure that government decision-making is conducted free from the corrupting influence of self interest, thereby restoring taxpayer confidence in the integrity of the public pension benefits and funding decisions.

Respectfully submitted,

Dated: January __, 2007

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CERTIFICATE OF WORD COUNT

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